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Politics this week

Jun 13th 2002
From The Economist print edition

Foiled

America's Justice Department announced that it had foiled in the early planning stage an **al-Qaeda** plot to set off a radiological bomb in an American city. The suspect, an American citizen, Abdullah al-Muhajir, had been detained in May; he was declared an enemy combatant and sent to an American naval base. Pakistan reported arresting several al-Qaeda suspects, at least one of whom may have been an American linked to Mr al-Muhajir. Donald Rumsfeld, America's defence secretary, said he had “indications” that al-Qaeda was active in the Kashmir conflict. Pakistan denied this.

See article: The continuing war against al-Qaeda

President George Bush announced that he would after all set up a new cabinet-level **Department of Homeland Security**. Headed by Tom Ridge, it will bring together 100 government organisations and answer to Congress.

See article: George Bush's management style

After a French news magazine, *L'Express*, reported the story, **Morocco** named three alleged al-Qaeda members, all Saudi nationals, who had been arrested last month in connection with a plot to attack American and British naval ships in the Strait of Gibraltar.

The **Anti-Ballistic Missile treaty** between America and Russia quietly lapsed, six months after America announced its withdrawal to vociferous dismay.

John Gotti, an American gangster called the Teflon don for his ability to evade the clutches of the law, died in a prison hospital.

Reuters

The Senate rejected Mr Bush's bid to repeal the **estate tax** permanently. The Republicans want to make inheritance taxes an election issue.

Afghanistan's grand council

Some 1,500 delegates from throughout **Afghanistan** met in a *loya jirga* (grand council) to elect a new government. Hamid Karzai, leader of the interim government, was expected to be voted president.

See article: Afghanistan's loya jirga

An American missionary and a Filipina nurse held hostage by Muslim rebels in the southern **Philippines** were killed in a gun battle when soldiers tried to rescue them. A second American survived.

See article: A bungled hostage rescue in the Philippines

New Zealand is to hold a general election on July 27th, four months earlier than necessary. Helen Clark, prime minister of the ruling coalition, believes her Labour Party will win a clear majority.

At least 180 people died and thousands were made homeless as the flood

season opened in **China**, with the north-western Shaanxi province the worst hit.

AP

Middle East middle-man

Preparing to pronounce on America's **Middle East** position, George Bush invited Hosni Mubarak and Ariel Sharon to Washington to air their contrasting views. Mr Mubarak's plea for a peace timetable was rejected; Mr Sharon's seemingly accepted. A suggestion from Colin Powell, America's secretary of state, that Mr Bush might endorse a “provisional state” for the Palestinians, received no support from the White House. On the ground the violence continued. A suicide bomber killed an Israeli teenager in Herzliya. The Israeli army again invaded several West Bank cities.

See article: American-Israeli good relations

Yasser Arafat restructured his cabinet, sweeping away 11 posts and appointing new ministers of the interior and finance. Nobody was greatly impressed, and Israeli tanks in Ramallah prevented the new cabinet from meeting.

AP

See article: The Palestinians under siege

A UN summit meeting on **world hunger** was attended by dozens of heads of state from poor countries, but hardly any from rich countries. Delegates called for more aid for the hungry and lower trade barriers to farm products from poor countries.

See article: The politics of hunger

South Africa's government released statistics suggesting that the rate of new **HIV** infections among young people is stabilising, a sign that the epidemic may have peaked. Peter Mokaba, a leading member of the African National Congress who denied that HIV existed, died, allegedly of AIDS.

Right for France?

The centre-right did well in the first round of **France's** general election, the far right of Jean Marie Le Pen did poorly and the Socialists did better than they had feared. Outlook: after the second round on June 16th, President Jacques Chirac will look forward to co-operating with a government of his own choosing, with luck for five years.

See article: France's centre-right is set to take power

After winning a general election last month, Bertie Ahern was confirmed as **Ireland's** prime minister and formed a coalition government similar to his previous one. He said his first priority was to secure a referendum “yes” for the EU's Nice treaty on enlargement, which voters rejected last year.

See article: Ireland's old-look new government

Germany's chancellor, Gerhard Schröder, dribbled cold water on a notion that the **EU's Council of Ministers** should have a long-term elected head. Its chief proponent is Tony Blair. Who can he think would fit the bill?

Rupert Murdoch, Britain's biggest media tycoon, said he would fight any move to adopt the **euro**. Good news for euro-haters?

Italy's parliament began voting on a controversial bill that would limit assisted reproduction, now unregulated there. It would also ban experimental research using embryos.

Russian youths rioted near Moscow's Red Square after their national football side was beaten in the World Cup by the joint hosts, Japan. Two people were killed and more than 100 arrested.

See article: A Russian football riot

AP

Cuba's not so sweet

Facing shortages of foreign exchange and energy, **Cuba's** communist government revealed that it plans to shut down almost half of the country's antiquated sugar mills.

See article: Hard times for Cuba's economy

Brazil's currency and its bonds continued to plunge this week, as investors worried about its election campaign and its public debt.

See article: Brazil's debt and its election

FARC guerrillas ordered mayors and magistrates in three departments of southern **Colombia** to quit, or risk death. Some 30 mayors fled their towns or resigned, and one was killed.

See article: A new threat from Colombia's FARC

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Business this week

Jun 13th 2002
From The Economist print edition

Fiat farewell

The latest manifestation of terrible troubles at **Fiat** was the departure of Paolo Cantarella, the Italian industrial group's chief executive. Mr Cantarella was particularly associated with the car division, the engine of Fiat's decline. Paolo Fresco, the company's chairman, will now assume the role of chief executive as well.

See article: Fiat loses its boss

Rupert Murdoch's **News Corporation** agreed to pay Vivendi Universal *euro*1.5 billion ($1.4 billion) for **Telepiu**, an Italian pay-TV company. However, NewsCorp must attract other investors if it is to bring its combined holding in Telepiu and Stream, a rival Italian pay-TV firm half-owned by News Corp, down to 50%, to avoid consolidating the combined group's losses into the parent's accounts.

From worse to bad

Nokia's shares climbed even though the company admitted that handset sales would grow at best by 4% in the current quarter over a year ago, and that network-equipment demand could suffer a fall of up to 25%. Investors, perhaps expecting worse, were encouraged by news that the world's leading mobile-phone maker had not cut its profit forecast.

France Telecom's rocky relationship with Germany's **MobilCom** led to divorce. The heavily indebted French company, which owns 28.5% of MobilCom, failed to dislodge Gerhard Schmid—holder of another 40%—as chief executive after claiming that he broke corporate law by lending to a firm owned by his wife without board approval. So France Telecom severed strategic links with MobilCom (and thus access to its cash); its shares dived by 46%.

Zomba Music Group exercised an option requiring Germany's **Bertelsmann** to buy the company for some $3 billion. Bertelsmann will acquire a roster of artists, including a schoolboy favourite, Britney Spears, and an ageing Welsh heart-throb, Tom Jones, at a time when the world music market is contracting.

Bank robbers

Eight **Austrian banks** were found to be involved in the “most shocking” cartel ever uncovered by the European Commission. The banks' bosses met frequently at a Vienna hotel to fix charges and rates. The commission levied fines totalling *euro*124m ($118m). Three banks are preparing to appeal (against the fines, not the charges).

See article: An Austrian bank cartel fined

Sam Waksal, chief executive of **ImClone Systems** until a few weeks ago, was arrested on charges of insider dealing. Mr Waksal's brother Harlan took over as chief executive of the American biotech company, which is already under regulators' scrutiny for misleading shareholders by withholding sensitive information.

Adelphia Communications hit more trouble. The American cable company fired its accountants, Deloitte & Touche, after having to restate cashflow and revenues for the past two years, a few weeks

after it emerged that Adelphia had made off-balance-sheet loans to its founders, the Rigas family. And two prominent board members resigned shortly after their appointment. Chapter 11 bankruptcy looms.

America's **Securities and Exchange Commission** kept up the pressure on company bosses by publishing draft rules requiring them personally to vouch for company financial statements, on pain of possible prosecution if they prove false or misleading.

The jury in the criminal trial brought by America's Justice Department against **Andersen** for its obstruction after the collapse of Enron last year announced that it was deadlocked on a verdict. The judge urged it to keep deliberating.

Brands that deliver?

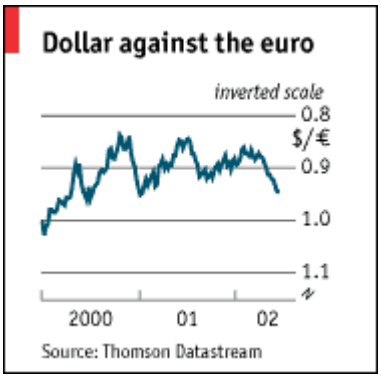
PricewaterhouseCoopers is to rename its consulting arm "**Monday:**", when it is spun off later this year. Eschewing the popular but meaningless cod-classical, PwC hopes that "Monday:" will inspire "fresh thinking", early rising and the wearing of "crispy white shirts". The many millions trudging to work heavy of heart on the first day of the week may not agree.

Consignia, formerly Britain's **Post Office**, decided that it would revert to a genuinely Tudor identity, **Royal Mail** (introduced in 1516). The company concluded that its bogus Latin rebranding had not done enough to reverse the failing business: it announced losses of £1.1 billion ($1.6 billion) for the year, and is to make more redundancies.

See article: Consignia's Allan Leighton

Down with the dollar

The **dollar** hit a 17-month low against the euro. Doubts about the strength of America's economic recovery, compounded by worries about corporate profits in the aftermath of a slew of recent accounting scandals, pushed the European single currency briefly above 95 cents and invited speculation that it may yet get back to parity with the dollar for the first time since February 2000.



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Fighting terrorism

The dirty bomber

Jun 13th 2002
From The Economist print edition

A worrying development, but also some progress

Get article background

WITH terrorism, the most important thing is not just the number of people you kill, but the number that you frighten. This week al-Qaeda proved that, even when suffering an apparent reverse, it can still strike terror into the hearts of Americans. On June 10th, the Bush administration, which has been on the defensive about intelligence failures, unveiled a success: a month ago, it arrested an alleged member of al-Qaeda at Chicago airport said to be in the early stages of planning a new attack. Yet for most Americans the announcement has only confirmed three unpleasant suspicions.

First, it seems to show that, despite its setbacks in Afghanistan, al-Qaeda is alive and plotting (see article). Indeed, it also emerged this week that other alleged terrorists have been arrested in Morocco, suspected of planning assaults on British and American ships. Second, the detainee in Chicago is an American citizen—a Latino gang member who converted to Islam in prison and adopted the name Abdullah al Muhajir. The confirmation of this enemy within is not only frightening in itself; the Bush administration has also had to jump through legal hoops just to keep Mr Muhajir in detention. Third, most devastatingly, the alleged attack was to be a “dirty bomb” set off in an American city. The nightmarish combination of a fanatic and radiological weapons, until recently the stuff of movies, has inched a little closer to reality—or so it feels.

A nuclear attack of any sort would be appalling. However, for the moment at least, the administration's warning about “mass death and injury” seems overwrought. Dirty nuclear bombs come in two different sorts. One, which involves wrapping weapons-grade nuclear material around a normal bomb, could indeed be devastating. The cruder sort, which adds civilian radioactive material stolen from places like hospitals would, in all likelihood, be only slightly worse than a normal bomb. So far, in fact, there is no hard evidence that al-Qaeda has managed to acquire either sort: the administration's revelations this week were strikingly thin.

A nuclear attack would be appalling. However, for now at least, the administration's warning about “mass death and injury” seems overwrought

That does not necessarily make them unjustified: when the threats are as grave as these, it does not pay to wait and see. To that end, George Bush has recently made two sensible strategic shifts in his war against terrorism. At home, he has announced the creation of a new Department of Homeland Security, bringing together 170,000 government workers under a common budget. Abroad, his administration has stepped up its earlier efforts to define a doctrine of “pre-emptive intervention”: America will in some cases strike before others strike it.

The danger of mass-destruction weapons of any kind makes the doctrine of striking first seem more justifiable—not just against al-Qaeda operatives but also, most crucially, against rogue states. In particular, the whole world has a vested interest in depriving Saddam Hussein of nuclear, biological and chemical weapons. Many of America's allies have been too keen to worry about the challenge of deposing Saddam, rather than considering the still greater challenge of living with the nuclear Iraq that he is trying to create. The decision to send troops is some way off; but, should Mr Bush reach that point, America's claim to be defending the world will have validity.

Yet if America's allies must accept some facts of life, then so must Congress and the White House. Friendly countries, such as Pakistan and Russia, are just as likely sources of nuclear material for terrorists as Saddam; protecting their stockpiles should be an equally high priority, yet the administration and Congress alike have been reluctant to expand the existing $1 billion-a-year programme devoted to this task. Also important, there is the question of removing the grudges against America that give fanatics so much of their power. The establishment of peace in the Middle East would help discourage future acts of terrorism: Mr Bush needs to give that quest even more attention than he is (see article).

A more secure homeland

At home, America's new defensive strategy is also incomplete. The homeland security department is, from one angle, long overdue. It is absurd that the US Customs and the Immigration and Naturalisation Service currently report to different cabinet departments. Having at first resisted the idea of giving Tom Ridge, his homeland security chief, a proper department and making him accountable to Congress, Mr Bush is now sensibly changing his mind. Yet Mr Ridge will have his work cut out: his vast empire covers plenty of things (even potentially supervising circus animals) that have little to do with bombs. Making 100 different organisations work together will still be difficult, not least because there is no shared single database.

Tighter borders and better protection for vulnerable sites will help thwart al-Qaeda. But many of the most worrying vulnerabilities in America's defences have been to do with intelligence gathering. Neither the FBI nor the CIA is included in the new department. That probably makes sense, but it is important that America reorganises its spy system. It has two endemic faults. First, there is no proper domestic intelligence service (although the FBI has now taken a few steps to reform itself in that direction). Second, there is no accountability: 13 agencies loosely report to the Director of Central Intelligence who has no real control over them. With luck a new congressional inquiry will suggest ways to simplify this mess.

Talk of more efficient spies and better databases will worry civil libertarians. Sadly, if people are thinking about blowing up nuclear bombs in America's cities, the balance between liberty and security must shift a little in the latter's favour. But it is also crucial that America defines any new restrictions on liberty carefully. The current laws, which treat suspects as either civilian criminals or enemy soldiers, seem out of date and arbitrary. Embarrassingly, Mr Bush's people had to invoke a tangential 1942 Supreme Court ruling on Nazi saboteurs to recategorise Mr Muhajir as an enemy combatant, largely to avoid presenting him to a judge. It would be fairer to pass clear, specific anti-terrorist laws, even if they were harsh ones. In this war above all others, America needs to fight by the rules, and not appear to be changing them on a weekly basis.

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China

Set China's politics free

Jun 13th 2002
From The Economist print edition

The country's new leaders look unlikely reformers. In which case China will change of its own accord

THE exact date has not yet been announced. But in a few months' time, starting with its five-yearly plenary congress, China's Communist Party will begin the biggest leadership reshuffle since the death of Chairman Mao in 1976. For China's sake, the party's policy should change too. For the passing of the baton to a new generation of leaders comes at a crucial juncture in China's development. The country's transition to a market economy has entered its most difficult phase.

China thinks it has learnt how to become rich. Its entry into the World Trade Organisation last December helped to clarify its economic objectives for the years ahead. But it has no comparable plan for the political changes needed to manage the wrenching ones that economic reform will bring. That reform is forcing the party to relax its grip over ordinary citizens' lives. But as the party retreats, it is still reluctant to let other forces fill the gaps. It remains suspicious of any new organisation, be it a charity or a consumer association, that it does not control itself (see our survey of China in this issue).

A party like there's no tomorrow

Having looked on aghast at the manner in which communism collapsed in the Soviet Union and its satellites, China's Communists do not want to loosen their power in a way that will lead to their own removal, with what they assume would be chaotic consequences. But refusing to adapt is also fraught with risks. By restricting the growth of new organisations set up by citizens without the involvement of party or government officials, China is depriving itself of a source of social stability. Though there has been some progress on this front—China is far from being the monolithic state of 20 years ago—its present leaders have clamped strict limits on how far they will allow such freedoms to spread.

On the face of it, the forthcoming change of guard is therefore an opportunity. The congress will mark the semi-retirement of President Jiang Zemin, party leader since the crushing of the Tiananmen Square protests in 1989. Li Peng, the party number two, who was closely associated with the Tiananmen crackdown, will also retire. Since public discussion of political reform has been virtually taboo under these men, their going might be thought to give their successors a chance to steer China towards a more pluralistic system of politics. In Taiwan, after all, the Communist Party's once very similar equivalent, the Kuomintang, ended up accepting the possibility of ceding power. Might China's leaders-in-waiting follow suit? There is scant sign of it. For the moment, the party's instincts, the known preferences of the new guard and the self-interest of the departing leadership all point in the other direction.

As its treatment of the Falun Gong movement shows, China's Communist party has an instinctive allergy to any form of political competition, no matter how indirect. It continues to wage a relentless campaign against this quasi-Buddhist cult, which was outlawed in 1999 after staging an unauthorised public protest demanding official recognition. Mr Jiang has mobilised huge resources to crush the movement. Apart from causing considerable suffering to millions of ordinary Falun Gong practitioners (thousands of whom have been sent to labour camps), the campaign has set back the development of civil society generally. Since clamping down on the Falun Gong, officials have been far more reluctant to

China's leaders-in-waiting, though much younger than the present ones, have so far given no evidence of

allow the registration of other non-governmental organisations.

having the needed imagination and courage

China's leaders-in-waiting, though a decade or more younger than the present ones, have so far given no evidence of having the needed imagination and courage. Hu Jintao, the vice-president and the man most likely to succeed Mr Jiang, has been groomed for the job for more than ten years. Like much else in Chinese politics, his policy preferences are difficult to fathom, but it is safe to say that the party does not go out of its way, on purpose at any rate, to groom Gorbachevs.

It may be that Mr Hu is merely keeping his plans quiet until he is safely ensconced in the top job. But even if he is a closet reformer, intent on unleashing far-reaching political changes once he takes charge, he will find it hard to do so. For Mr Jiang and others of his generation will continue to wield influence from behind the scenes. The elders do not want their semi-retirement spoiled by political liberalisation, not least because it would lead sooner or later to embarrassing public questions about their roles during the Tiananmen Square massacre. Its 13th anniversary passed quietly earlier this month, with most Chinese paying more attention to their country's debut in the World Cup. But the party recognises that it remains a highly sensitive issue just beneath the surface.

Why fix what ain't broke?

However, the strongest reason of all to doubt that China's new leaders are intent on radical political reform is the fact that they do not yet seem convinced of the case for it. Many Chinese—and many outsiders who ought to know better—are beguiled by China's recent successes. The 13 years since Tiananmen have after all been among the most peaceful in China's turbulent history; the economy has grown at breakneck speed; and WTO membership has put China on a glide path towards a smooth docking with the world economy. Compared with the chaos that afflicted the Soviet Union when it started to reform, China's path towards market economics has been a model of stability. Why mess with success?

Because without a new sort of politics, the successes will stop. Having had 13 years of relative stability does not guarantee another 13, especially given that the stability is more apparent than real. Today's China is full of disaffected people, from unemployed workers to overtaxed peasants, seeking a political channel through which to pursue their demands. The momentous changes reshaping the economy require new mechanisms for the state to mediate between contending interest groups. China's new leaders will probably err on the side of caution, at least until they consolidate their power, which may take a long time. But the longer they delay, the more likely it becomes that change will take place of its own accord—suddenly, and in a manner beyond their control.

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World hunger

Stop blaming the weather

Jun 13th 2002
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The world grows enough food. What the hungry need is economic growth

Reuters

HUNGER is the natural state of mankind, but the good news is that mankind is moving away from nature. Although the world's population has grown sixfold in the past two centuries, food production has grown faster. Better and more widely-applied technology—hybrid seeds, fertilisers and so on—has allowed farmers to coax more calories out of each hectare. Future innovations, including genetic modification to produce more nutritious cereals and livestock, should keep the planet's larders well-stocked. But, as this week's UN World Food Summit showed (see article), this is no cause for complacency.

The absolute number of malnourished people is declining by about 5m a year. As a proportion of the world's population, the improvement is even more marked. But that still leaves 800m people hungry, which translates into a lot of suffering. Underfed children succumb more easily to disease, and are often stunted both physically and mentally, making it harder for them to earn a living as adults.

Hunger is caused by bad weather, but even more by bad government. Well-governed countries never suffer famine; but of the 25 worst-nourished nations, all are badly governed, some spectacularly so. Little can be done about the weather, at least in the short term, but policies can change.

Farmers in poor countries are no longer herded at gunpoint into collectives, a policy that killed millions in the 20th century. But men with guns still reduce farmers' incentives to grow food in countries where wars rage. In eastern Congo, nobody wants to raise cattle, because marauding soldiers steal them. Even in peaceful poor countries, land tenure is often insecure. In Zimbabwe, the government grabs land and gives it to supporters, which has caused farm output to plummet.

In many countries, individuals are not allowed to own land, or find it hard to gain formal title to it, which makes it impossible for small farmers to use their fields as collateral so as to raise cash to invest in better farming techniques. It is not only farm policies that matter. The poorest will be able reliably to feed themselves only when they are less poor. To achieve this, poor countries need property rights, enforceable contracts, macroeconomic stability, freer trade and non-predatory government. The hungriest lack most of these.

The UN summit is calling, inevitably, for more aid. But the biggest favour the rich could do the poor would be to give less aid—to their own farmers. Rich countries protect their farmers with subsidies, high tariffs, import quotas and a tangle of other barriers masquerading as health and safety standards. This makes it hard for farmers in poor countries to sell their produce in rich countries. The World Bank says that ending northern protection would boost poor countries' annual GDP by $30 billion, which would buy quite a few lunches.

The biggest favour the rich could do the poor would be to give less aid—to their own farmers

Unlike aid, freer trade does not foster dependence. And whereas aid costs money, cutting farm subsidies would save rich-country taxpayers a billion dollars a day, as well as letting those who eat do so more cheaply. Some northern farmers might suffer, but supporting them while they look for other work would be far cheaper than the current system. Besides, most of the rich world's subsidies go to the richest farmers, many of them millionaires. They certainly won't starve.

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Corporate governance

Under the board talk

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From The Economist print edition

American companies need stronger independent directors

THE muttering about America's corporate-governance failings seems to be getting ever louder. After Enron, Global Crossing, WorldCom and Tyco, more and more shareholders have been calling not only for external-audit reforms but also for greater internal checks on chief executives whom, with the wisdom of hindsight, they now perceive to have been overly dominant. This debate is narrowing down to how to strengthen companies' boards of directors, without sacrificing the entrepreneurship and risk-taking that have been characteristic of many of America's most admired (and sometimes most successful) bosses in the past two decades.

The first thing to note about this is that it is unlikely to be settled in Washington. Earlier in the year, Congress was breathing fire about audit reform, including tougher regulation of accountants and banning firms from doing consulting work for their audit clients. Yet, as so often, the fire has been deftly extinguished by deep-pocketed corporate lobbyists. The shameful prospect now is that Congress may not enact any audit reforms at all. Alas, it would be equally otiose to look for legislation to change corporate governance.

That does not, fortunately, mean that nothing can be done. Indeed, what is going on outside the legislative arena is more encouraging than what is happening on Capitol Hill. The Securities and Exchange Commission is pursuing changes to audit regulation and accounting standards. This week, the SEC proposed to require chief executives to vouch personally for financial statements. And last week the New York Stock Exchange, acting at the SEC's request, published new proposals to strengthen corporate governance for listed companies. These plans, which are now out for a two-month consultation period, are a useful step forward.

The proposals include a few gestures towards the corporate social responsibility lobby, such as a requirement that listed companies should publish corporate-governance guidelines and a code of ethics on their websites. But the main focus has been on ideas for strengthening the role of independent (non-executive) directors, by demanding that a majority of the board consists of independent directors, that audit and remuneration committees be composed only of such directors, and that they meet each other and company managers without the chief executive being present (see article).

The search for talent

Welcome as these ideas are, they leave several issues untouched. One is how directors are chosen. For too long, supposedly independent directors have been anything but—steered on to the board by powerful chief executives, on whom they are too often dependent for favours, loans or business. To break this mutual back-scratching, shareholders should play a bigger role in the selection of directors, if necessary by engaging in a proxy contest. Directors should also be barred from having potentially compromising business relationships with the company. And there is a case for a stronger institutional check on the boss by copying the British and Canadian practice of separating the job of chief executive from that of chairman. A non-executive chairman can act more effectively as a lead independent director when it comes to such tricky matters as dropping an underperforming chief executive or picking his successor.

Perhaps the biggest difficulty is to find enough good candidates to be directors in the first place. Whenever burdens on directors rise, or lawsuits multiply, the cry goes up that nobody will do the job. Yet

most companies fish for directors from a tiny pool, too often bosses of other firms. Why not trawl more widely, among academics and public servants, say? Why not advertise the jobs, paying more if need be? And then there is the growing band of retired or fired former bosses. They, at least, know what tricks to look for.

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America, Israel and the Palestinians

An opportunity missed?

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From The Economist print edition

The dangers will grow if George Bush accepts Ariel Sharon's reasons for putting off talks

Get article background

AP

WITH relations between Israel and the Palestinians close to their darkest hour, few believe that the two unaided can reach any sort of dawn. Vigorous outside help has become indispensable. Sadly, it looks as if that too will be denied.

A few weeks ago there seemed a slight chance that the conflict's escalation, and spreading dangers, would persuade outsiders with influence to make the painful move from spectator to partner. Arab governments, led unexpectedly by Saudi Arabia, stated openly that their half-century of war, hot or cold, with Israel would end when it returned to the Palestinians the land conquered in 1967. The European Union, which has helped to finance the Palestinian Authority, was prepared to use such influence as it has. And the American administration, which alone might be able to persuade the Israeli government to do something it does not want to do, seemed to accept that it could no longer linger on the periphery.

But George Bush's reception of his two latest guests—Egypt's president, Hosni Mubarak, and Israel's prime minister, Ariel Sharon—suggests that the administration is not, after all, prepared to take on the unrewarding Middle East (see article). Mr Bush is soon to make a statement on America's position. On present evidence little of substance can be expected. Mr Mubarak, who requested America's support for a timetable of steps towards Palestinian statehood, got short shrift. Mr Sharon, who argued that no political negotiation could be begun until the Palestinians stopped all violence and reformed their institutions, was smiled upon.

Mr Sharon's conditions mean, in effect, no negotiation. Violence has served the Palestinians ill. Terrorism by the few (albeit supported by the many) has brought the whole nation into disrepute; the resurrection of the *intifada* has caused deep suffering. But the abandonment of the armed struggle needs a glimpse of light at the end of the political tunnel—and the current Israeli government allows no glimpse. Mr Arafat's attempts to restructure his administration have been dismissed with disdain; Israel's view of “reform” now means getting rid of the ailing and failing autocrat himself.

The abandonment of the armed struggle needs a glimpse of light at the end of the political tunnel—and the Israeli government allows no glimpse

The personal demonisation of Mr Arafat has taken over Israel. As the Israeli army batters and besieges his Ramallah office, his survival is at Israel's call. But by now his presence may be useful to Mr Sharon, protecting him against unwelcome political urging from America. Mr Arafat might be cunning if he were to call Mr Sharon's bluff by handing over his executive powers to someone who would be better able to explore whether Israel's prime minister really has an alternative policy to military might. Since the Palestinians' leader is unlikely to do this—and throwing him out at the point of an Israeli gun could result in chaos—America should not accept the Israeli article of faith that everything bar force has to be put on hold so long as Mr Arafat is around. Though he is far from the best leader the Palestinians could have, he is the one they have.

Central to the war on terror

Of course, no American president, especially after Bill Clinton's experiences, seeks willingly to get snarled up in the Middle East. From a domestic point of view it is almost certainly a loser; Mr Bush's foreign priority remains the war on terror. But the Israeli-Palestinian conflict, far from being containable, encroaches octopus-like on the larger war. The Arab world's anti-Americanism draws vitality from the assumption that the United States, its interest in the Middle East limited to oil and Iraq, supports Israel in its occupation of Palestinian land. This is not America's position. But the poison will spread unless America's leaders accept the centrality of Israel and Palestine to their country's strategic interests, and show their determination to help the two peoples towards that elusive peace.

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Letters

Jun 13th 2002
From The Economist print edition

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Matters of state

SIR – You misplace your criticism when you argue that the worst result of the recent settlement with Merrill Lynch concerning conflicts of interest and analysts is that it was reached at state level ("Thunderstruck", May 25th). States, rather than federal officials overseeing vast bureaucracies, are often the first recipients of public complaints and are therefore first to investigate misdeeds. For instance, state regulators were the first to call attention to: fraud in microcap-equity markets; unsubstantiated hype of day-trading firms; hyperbole surrounding online trading; and the practices of flipping and penalty bids in hot initial public offerings. The state actions eventually led to broader national rules on day trading and margin disclosure, online investing and new advertising standards. Without the states would these issues have evoked a federal reaction?

States are not unmindful of the global nature of "bulge bracket" investment banks and welcome investigation by the Securities and Exchange Commission of issues implicit in the Merrill settlement. However, without the New York attorney-general's action, would the SEC have reacted in a timely fashion?

John Maher
Commissioner, Pennsylvania Securities Commission
Harrisburg, Pennsylvania

After Thatcher

SIR – You overlook the main reason why Thatcherism remains on the European political agenda more than a decade after Margaret Thatcher left office ("Is Margaret Thatcher winning in Europe?", June 1st). There has been no "-ism" since then worth railing against. At the time, I disagreed with almost everything Lady Thatcher said and did, but at least there was something definitive with which to disagree. Bland, consensus-driven populism has characterised European politics post-Thatcher. It does not evoke strong passions either way. Little wonder that European electorates have become so unsinterested.

Simeon Preston
Singapore

SIR – I must challenge Bagehot's contention (May 4th) that Tony Blair is Britain's first post-ideological prime minister. Surely that honour goes to John Major. Those living in Britain during his premiership could not possibly accuse him of thinking about anything except how to cling to power.

John Graham
Alexandria, Virginia

Mind how you go

SIR – You miss a crucial difference between genetics and neuroscience ("The future of mind control", May 25th). The effects of neuroscience are reversible or, at least, they last only for the lifetime of the individual concerned. The effects of genetic engineering can have dynastic continuity; modifications or enhancements may be passed on to later generations. The use of neuroscientific treatment can be

justified partly through arguments about freedom of choice; an individual born with genetically altered traits has no choice in the matter.

Georg Blaha
Berlin

SIR – As a neurologist (with a special interest in neurodegenerative disorders), I am concerned about the freedom of scientific inquiry being curtailed. Your article sounds like an incitement to make yet more laws that could interfere significantly with the kind of work I want to do—for example, developing treatments for neurodegenerative disorders, including electric-brain stimulation, stem-cell implantation and modification of cell genomes. Just as the onerous laws regulating molecular biology did not help anybody but instead harmed many people by slowing down technological progress, the enactment of yet more rules specifically regulating brain science would also do more harm than good.

A healthy debate is needed but with the understanding that with lawmaking less is more and, paradoxically, late is better than early.

Rafal Smigrodzki
University of Pittsburgh
Pittsburgh

SIR – So the dangers of neuroscience include the advent of “drugs to combat sleepiness”? I nearly spilled my morning coffee.

Tom Stafford
Sheffield

Singapore's state-ownership

SIR – You claim that the Singapore government's “habit of promoting particular businesses sits ill with its purported aim of withdrawing from business altogether” (“Picking the losers”, June 1st). The Singapore government has no such habit. It does hold shares in a range of companies. Some are former government departments which were spun off—eg, Singapore Telecoms. Others are part of our economic history—eg, Singapore Airlines resulted from the break-up of Malaysia-Singapore Airlines. However, the roast-duck business, an incidental acquisition, was disposed of long ago in 1994. The government will only retain control of companies that are critical to Singapore's security or economy, or that have the potential to grow internationally. It will progressively divest businesses that do not fit these criteria, as market conditions permit. Since 1985, about 65 companies have been partially or fully divested.

We have a small population and talent pool and we have systematically recruited talent into the public service and armed forces. So it is not surprising that some former bureaucrats and soldiers serve on company boards. Like all other directors, they are appointed strictly on merit, to meet the needs of the companies. One critic whom you quote complained that “the government has been in business so long, and has made so much money out of it.” That is a tribute to the companies and their directors.

One Ye Kung
Press secretary to the deputy prime minister and minister for finance
Singapore

Suburban myths

SIR – Superhero comics were forced long ago to cater to a population that was increasingly suburban (“Heropolis”, May 18th). This transition started over 30 years ago. Peter Parker, Spider-Man's alter ego, grew up in suburban Queens. And the X-Men, comicdom's most popular heroes and the subjects of a popular movie that you overlook, are based somewhere in Westchester, New York. It is worth noting that the most recent retellings of classic superhero stories like Superman (in “Smallville”) or Spider-Man (in the current comic book) and even comic-inspired heroes like “Buffy the Vampire Slayer”, are set mainly in suburbia.

Kamalesh Rao
New York

Spanish practices

SIR – Spanish customers currently paying *euro*1 (166 pesetas) for services which, less than a year ago, cost 100 pesetas may disagree with your assertion that it is too early to separate the effects of the introduction of the euro from normal year-on-year price increases ("Hold the foie gras", May 25th). Hence, some people have taken steps to realign prices. Thai ten-baht coins (virtually identical to *euro*2 coins but with one-eighth of the value) are being passed to the unwary.

David Mestres
Barcelona

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The war on terror

America the still-vulnerable

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AP

A “dirty-bomb” plot has raised new worries in the war against terrorism. New hopes, too

Get article background

THE disruption of an alleged al-Qaeda plot to plant a “dirty bomb” in Washington, DC, came just over a week after President George Bush had called on America “to be ready for pre-emptive action to defend our liberty”. Between them, the two events mark a new stage in the war against terror.

After months of agonising over who knew what before the September 11th attacks, the country is now turning its attention to the threat al-Qaeda still poses. At the same time, the administration is getting to grips with the question of how far the doctrine of preventive action—largely uncontroversial in the case of specific threats from non-state terrorists—applies to countries that sponsor terrorism or have covert nuclear-weapons programmes.

The arrest of Abdullah al-Muhajir at Chicago's O'Hare airport emphasised the obvious: that the war in Afghanistan has scotched the snake, not killed it. He had been arrested, said John Ashcroft, the attorney-general, while on a trip to identify targets for a “dirty bomb” (a conventional bomb designed to spray radioactive dust over parts of a city). Mr al-Muhajir is said to be a member of al-Qaeda. A second, unnamed, suspect in the plot has been arrested in Pakistan. Information released by the administration about this operation is fragmentary, to say the least; but so, too, may be its knowledge of what it says was to be al-Qaeda's first planned attack on an American city since September 11th.

It would not have been the first planned attack against Americans. Last December, Richard Reid, a British convert to Islamic terror, was arrested on a flight from Paris to Miami after apparently trying to detonate a bomb hidden in his shoes. Nor was it the first al-Qaeda attack since September 11th. On April 11th, a truck bomb killed 19 people at a synagogue in Tunisia. On May 8th, a bomb exploded in Karachi, killing 11 French naval engineers. And on June 11th, police in Morocco announced the arrest last month of five Saudis (two of them women) and 15 Moroccans, some of whom claimed to be part of al-Qaeda. They were said to be planning to attack American and British warships in the Strait of Gibraltar, just as al-Qaeda had done in October 2000, when it floated a dinghy full of explosives into the *USS Cole*, in harbour in Yemen, killing 17 Americans.

There is little doubt that al-Qaeda remains capable of planning and completing the sort of conventional terrorist bombings for which it was known until last year. With operations in America, Tunisia and Pakistan (as well as continued signs of activity in Europe), the group retains a widespread network and a headquarters capable of giving orders and moving people around. This is hardly surprising, given that Osama bin Laden may still be alive and given al-Qaeda's cell-like structure. Beyond those general points,

though, several conclusions emerge from the particular case of the “dirty bomber”: two worrying, two more comforting.

New plots, new recruits

Begin with the worrying bits. First, if true, the dirty-bomb plot suggests that al-Qaeda is moving closer to its long-threatened deployment of a radiological, or even a nuclear, bomb. Mr bin Laden himself has said that getting and using an atomic device (he does not distinguish between nuclear and dirty bombs) is an Islamic duty. He is said to boast of possessing such a device, a claim apparently supported by an account, first reported in the *Washington Post* last December, of an al-Qaeda member waving a canister around at a secret meeting, claiming that it contained radioactive material.

Even if that is so, it is impossible to tell how near Mr al-Muhajir came to setting off a dirty bomb. Some reports say he had received training in Pakistan in the sources and usage of radiological material. That implies he was not merely a scout, but possibly planned to steal radiological material and help in building a bomb. On the other hand, no bomb-making material or equipment seems to have been found on him, and top American officials give different estimates of how imminent his plot was. But whether the plan is five months or five years away, al-Qaeda seems to have reached a stage where it is planning the details of a radiological explosion.

Second, the group seems to be broadening its base of membership. Mr al-Muhajir is an American citizen. He was born in Brooklyn as Jose “Pucho” (Chubby) Padilla. He moved to Chicago as a child and later converted to Islam after a spell in jail in Florida. Assuming he is indeed an al-Qaeda operative, he would be the first American known to be a member of a covert cell. (Two other Americans, John Walker Lindh and Yaser Esam Hamdi, also have links with al-Qaeda, but they were both captured in Afghanistan and Mr Hamdi is American only by accident of birth: he was brought up in Saudi Arabia.)

Al-Qaeda has long been trying to recruit Americans. This is the clearest evidence it has succeeded. But it is not quite the first example of its kind, and may not be the last. Before his conversion, Mr Padilla was a member of a Chicago street gang called the Latin Disciples. There is a curious and disturbing link between such gangs and terrorism. In 1987, four leaders of another Chicago gang, called El Rukn, were convicted of taking $2.5m in exchange for planning terrorist actions in America, allegedly on behalf of Libya. Possibly al-Qaeda has gone fishing in the same pool. It is also quite likely to find recruits among Muslims in America, as it has done among Muslims elsewhere.

Al-Qaeda has long been trying to recruit Americans. This is the clearest evidence it has succeeded

Recruiting Americans has several advantages for al-Qaeda. It circumvents immigration problems and allows the group greater freedom of manoeuvre. It casts doubt on American “watch-lists” of suspects. Middle Eastern men have been top of those lists. No one expected that an American citizen would join al-Qaeda, let alone a Latino Muslim. The watch-lists will have to be rejigged. Al-Qaeda, in short, can still spring surprises.

All that said, the other lessons of the dirty-bomb plot are more comforting. Most obviously, America's intelligence agencies not only seem to be co-operating with one another—as Robert Mueller, the head of the Federal Bureau of Investigation, went out of his way to stress when announcing Mr al-Muhajir's arrest—but they also seem to have found effective sources of information about al-Qaeda.

The most important of these appears to be Abu Zubaydah, the group's operations chief, who was captured in Pakistan in March. Mr Zubaydah told American intelligence about the dirty-bomb plot, though not who was involved. The Central Intelligence Agency's other sources were good enough to pinpoint the people involved and to track them down. FBI agents then secretly boarded Mr al-Muhajir's plane to America. After more than a month in which the FBI and CIA have been at each others' throats, this co-operation was a welcome relief. So, too, was the intelligence agencies' decision in this case to move away from surveillance towards more disruptive, preventive actions—though some think the spur to action was less operational than political, as a way to chalk up much needed success.

Reuters

Other warships are in their sights now

Lastly, it is worth noting the significance of Mr al-Muhajir's trip to Pakistan. Despite all the fears of “autonomous” cells lying dormant in their unwitting host nations, this suggests al-Qaeda still needs a headquarters to function. It used to be Afghanistan. The shift to Pakistan confirms that American military action has disrupted the old base, though not destroyed it. It is also a reminder of the importance of America's alliance with General Pervez Musharraf, Pakistan's president, which brings the hope that the Pakistani base may one day be closed down, too.

But that is for the next stage of the operation. Meanwhile, the links between prevention, al-Qaeda and host countries lead on to the other main change in the war against terror. In the campaign against non-state terrorists themselves, preventive action is relatively uncontroversial. In the case of Afghanistan, America's military action was not only a response to the September attacks but also a pre-emptive strike against more. Shouldn't preventive action also be considered against other states that may be playing host to the same evil elements, or seeking to acquire weapons of mass destruction for their own aggressive purposes?

The limits of pre-emption

On June 1st, Mr Bush gave his answer: yes. In a speech at West Point, he argued that the cold-war doctrines of containment and deterrence could not work against terrorists or dictators with nuclear bombs. The threats are so ghastly that “if we wait for [them] to fully materialise, we will have waited too long.” And he drew the inference: America must “be ready for pre-emptive action when necessary.”

Mr Bush was not speaking loosely. Five days later, his vice-president, Dick Cheney, repeated the dose (“where necessary, [we must] pre-empt grave threats to our country before they materialise”). Officials say the doctrine of pre-emptive action will be formally embodied in a document called the National Security Strategy Report, which the administration must present to Congress soon.

Yet, taken at its broadest, this doctrine is disturbing. America must obviously be the judge of its national security, so the administration seems to be outlining for itself the right to attack any country on the basis of its own judgment, and presumably on a calculation that it is more likely to win a conflict and avert catastrophe if it strikes earlier (pre-emptively) not later. But what circumstances does the administration have in mind? Is it referring to terrorist threats? Or to the proliferation of weapons of mass destruction? Or both?

Operationally, a doctrine of pre-emption would require far better intelligence about where its enemies' military capabilities are, if America is to destroy them. At the moment, the administration has no idea where (for example) all Iraq's military installations are. In years to come, the doctrine would also require new weapons capable of destroying installations hidden far underground. Hence the Pentagon's interest in both new conventional weapons and possibly in so-called “bunker-busting” nuclear devices.

America could claim a broader justification for a doctrine of pre-emptive strikes from a United Nations resolution of September 28th last year, which called on all states to prevent terrorists from operating within their borders. But the resolution does not authorise force, let alone give America *carte blanche* for such actions.

The new doctrine is likely to end up somewhere between the UN resolution and the president's broad-brush call for pre-emptive action. At the moment, the administration is still trying to figure out where. That is one of the toughest policy challenges in the second stage of the war against terror.

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The legal questions

If in doubt, jail him

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The administration seems to be making the rules up as it goes along

AP

Charged with no crime and held indefinitely

Get article background

EVER since the September 11th attacks, George Bush has repeatedly spoken of the need to bring the terrorists to “justice”, and to defend democracy and the “rule of law”. Hours after it was announced on June 10th that Abdullah al-Muhajir had been transferred to military custody, the president eloquently declared that the “rule of law” and “limits on the power of the state”, were “non-negotiable demands of human dignity” in America's battle against terrorists. Yet what particular rule of law is Mr Bush referring to? And under what legal authority precisely is the alleged al-Qaeda bomber being held?

After Mr al-Muhajir was arrested on May 8th in Chicago, he seems to have been brought before a federal judge and given a lawyer as a “material witness” to a grand jury investigation into the September 11th attacks. For some reason, American prosecutors hoped at first that he would co-operate and provide information. But he refused to say anything. A federal judge recently ruled that such witnesses could not be held indefinitely. Prosecutors were facing another court hearing on June 11th at which the judge seems to have insisted that they either charge Mr al-Muhajir with a crime or release him.

Prosecutors have charged both John Walker Lindh, an American citizen, and Zacarias Moussaoui, a French citizen, with terrorist crimes, and both are being put on trial in federal courts. But either because they did not have enough admissable evidence against Mr al-Muhajir to convict him, or because they did not want to reveal the sources of that evidence, prosecutors decided not to charge him. Another option was to grant him immunity from prosecution and compel him to testify. If he then refused, he could be jailed.

Instead, the president issued an order listing Mr al-Muhajir as an “enemy combatant” and transferring him to military custody. The administration defends this action by citing a 1942 Supreme Court ruling on a military-tribunal trial of eight Nazi saboteurs in the second world war. But the court did not, in fact, decide whether one of the Nazi defendants was an American citizen or not, so its statements about the subject are not necessarily binding. Moreover, America was then in a war formally declared by Congress, which had also granted the president extraordinary powers. Neither is true today.

The same Supreme Court case is used by the administration to justify Mr Bush's executive order last November establishing special military tribunals. But Mr al-Muhajir cannot be tried by one of these,

because they can only be used for non-Americans. Mr Bush could extend their jurisdiction to American citizens—but that might look as if he were making laws up to fit particular cases, as dictators do.

Like the Guantanamo detainees, Mr al-Muhajir has not been charged with any crime, and the government has been careful not to say that he is a prisoner-of-war. Nevertheless, it seems to believe that it can hold him indefinitely and deny him access to his lawyer, who has nevertheless filed a challenge to his detention with a federal judge in New York. In a similar case, Yaser Esam Hamdi, a Saudi student, was transferred from Guantanamo to American soil when it was discovered that he was born in Louisiana and was therefore, at least theoretically, a citizen. Last month a public defender convinced a federal judge that Mr Hamdi deserved the right to a lawyer and an inquiry into his detention. The government has appealed that ruling.

If there is a way out of this labyrinth, it is not clear that the Bush administration wants to find it. It knows the court challenges could take months, if not years, and that in the case of the Guantanamo detainees there will be no challenges because no court has jurisdiction. Its most urgent priority is to gather information about possible future attacks. Interrogating prisoners is one way to do that. And yet such an ad hoc approach threatens seriously to undermine Mr Bush's laudable aim of defending the “rule of law”.

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Radiological devices

Weapons of mass dislocation

Jun 13th 2002
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How dirty bombs are made, and what they can do

AP

Too much radioactivity around

EVER since the September 11th attacks, it has been clear that the capacity of al-Qaeda and its affiliates to plot death and destruction is limited only by the power of the weapons they can obtain. Keeping nuclear, chemical and germ weapons out of their hands has therefore been a priority.The arrest of Abdullah al-Muhajir on suspicion of plotting to build and set off in America a radiological device—a “dirty bomb” that uses radioactive materials packed around a conventional explosive core—is an indication of how hard that fight will be.

Why a radiological bomb? Unlike chemical, biological or even the more familiar sort of nuclear-fission bombs, radiological weapons have never been used. Only Iraq's government is thought to have experimented with them for deployment on the battlefield. It is not just that they cause far fewer casualties than their atomic cousins. Like chemical and biological weapons, which are already outlawed, radiological weapons have long been considered inappropriate for military use. But for the al-Qaeda breed of terrorist, such weapons have value precisely for their power to shock.

All do-it-yourself mass-destruction weapons have their drawbacks. Nuclear fission bombs are devastating—think of Hiroshima and Nagasaki in 1945—but require technical skills that would be hard, though not impossible, for terrorists to master. Getting hold of enough weapons-grade enriched uranium and plutonium is also not easy. Chemical weapons, by contrast, can be simply made from fertiliser or pesticides, though more deadly nerve agents need considerably more expertise. But you need a lot of chemical agent to produce a lot of casualties. Germ weapons can kill with much smaller doses—either of viruses or bacteria—but are hard to deliver effectively. The anthrax-laced letters sent through the United States postal system last year resulted in only 18 confirmed cases of the disease and seven deaths.

Radiological weapons have their drawbacks, too. Technically, they are not weapons of mass destruction at all. In most cases, the greater risk to those nearby would be from the conventional explosives used rather than the radioactive materials dispersed.

Even the long-term health effects of heightened radiation exposure after such a device exploded are quite uncertain, according to Abel Gonzalez, the director of radiation and waste safety at the Vienna-based International Atomic Energy Agency (IAEA). The Chernobyl nuclear accident in Ukraine in 1986, he points out, pumped vastly more radioactive material into the atmosphere than any imaginable “dirty bomb”, yet scientists are still trying to guess what real effect this will have on cancer rates among people exposed to fall-out from the radioactive plume that spread across Europe.

The point, says Mr Gonzalez, is that however uncertain the health effects, sensors can immediately pick up even a slight increase in background radiation. Given people's fears about radiation exposure, it would be panic, rather than the numbers of dead or damaged, that would give the terrorists their success. It is this psychological impact, combined with their ease of assembly, that makes radiological devices so attractive to terrorists.

First find your cesium

Officials trying to stem nuclear proliferation used to congratulate themselves that only a very few of the

known incidences of trafficking involved the sort of uranium and plutonium useful for a bomb. Yet the black market in materials of the sort needed for a dirty bomb is much bigger. These materials include low-grade waste from power stations and small devices containing radioactive materials—such as cesium-137, used in some cancer treatments, cobalt-60, used in food irradiation, or americum, incorporated in sensors for oil exploration.

Such materials have literally hundreds of applications in industry, medicine and university research, and they are scattered about the world accordingly. Although the IAEA has for some years been prodding governments to tighten up procedures, it is only recently that some of them have started to take notice. Controls over such devices are often poor, and get poorer still when the devices themselves have outlived their usefulness.

Every year in the United States, a couple of hundred such devices are known to go missing—lost, stolen or simply abandoned. The would-be dirty-bomber now in custody would not have had to look abroad for his materials. The record in other countries is often worse. This week, an IAEA-led team was fanning out in western Georgia in search of the remaining two of a batch of eight abandoned devices containing strontium-90, another radioactive element, which had been used in generators for communication stations. Similar generators with radioactive elements are known to litter remote parts of Russia.

Many governments keep no record of such “orphaned” devices, although, over the years, they have been known to turn up in scrap metal without any terrorist involvement—and, without use of any detonator, have still caused horrible damage. In 1987, a scrap-scavenger in Brazil unwittingly cut up a canister containing cesium powder which he had stolen from an abandoned clinic: the resulting contamination left several people dead and 28 with radiation burns. The clean-up produced 3,500 cubic metres of radioactive waste and left the local economy devastated.

Dirty bombs made of such materials might better be called weapons of mass dislocation. A recent study by the Federation of American Scientists tried to estimate the health and other effects of three relatively small bombs, detonated in either New York or Washington, designed to disperse radiation in quantities that might be found in a stolen medical device or some other industrial radiation source. Estimates of injury and damage, it is admitted, could be out either way by a factor of ten: much depends on the nature of the material used and on prevailing weather conditions. In each case, however, the number of immediate deaths and injuries was thought to be relatively low. It was decontamination, in areas from a few to dozens of city blocks, that posed the greatest challenge. Often the only solution would be demolition. It was these economic consequences, from the costs of cleaning up to longer-term damage to business, running together into tens or hundreds of billions of dollars, that proved devastating.

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Los Angeles without the Valley

The road to Camelot

Jun 13th 2002 | LOS ANGELES
From The Economist print edition

AP

Can the ultimate suburb become America's sixth-biggest city? And why would it want to leave Los Angeles?

Get article background

VAN NUYS, according to Robert Redford, who grew up there, “was just this furnace that could destroy any creative thought that managed to creep into your mind.” Scorn and derision have long been the lot of the suburban tracts of the San Fernando Valley, 222 square miles (575 square kilometres) that make up the northern 45% of the city of Los Angeles. But the mall-thronged butt of “Valley-Girl” jokes has finally had it with mockery: its residents have grabbed a chance to assert their independence.

That chance will come in a ballot on November 5th on whether or not the Valley should formally split itself off from the rest of Los Angeles and become a separate city. More than injured pride is at stake. For years the Valley, cut off from the rest of the city by the Santa Monica Mountains, has received less in municipal services, such as public transport, than its residents have paid in city taxes. And even if it were receiving its fair share of services, the big city does an inefficient job at providing them.

By virtually any measure, the Valley gets a poor deal for its money. It contributed $1.3 billion in taxes for the new subway, and got only the very end of one line. (Merely mentioning the new palatial headquarters of the Metropolitan Transit Authority downtown incites fury in the Valley.) There are also markedly fewer police officers and libraries in the Valley, when set alongside the rest of the city.

The secession movement has simmered since the 1970s, when resentment against the city government flared up over school busing. It gained official recognition in 1998 with the efforts of Valley Voters Organised Toward Empowerment (or Valley VOTE) to gather up enough signatures to put the proposal on the ballot. The ballot measure got final approval in May this year, after a study showed that the new city could be economically self-sufficient.

Dissatisfaction with the government of Los Angeles has also come to a head elsewhere. Hollywood, which straddles the Santa Monica Mountains, has its own secession movement, and on June 5th its independence vote was also approved for the ballot (although a

tricky problem awaits over ownership of its famous hillside sign, which lies on land that would remain part of Los Angeles). The region around the vast port in the south of Los Angeles has also tried for independence, but the local government commission judged that it could not survive financially as a separate entity.

For a region to break away, secession must win both a majority of the votes cast within the boundary of the proposed new city and a majority of the votes cast across the whole of Los Angeles. In recent polls the percentage supporting secession by the Valley, which has 37% of the city's population of 3.7m but a higher share of its voters, has run in the high 50s locally and in the high 40s city-wide. If the secession vote wins, the new city would come into being on July 1st next year. Its name would also be decided in November's ballot, which will offer voters five possibilities, from plain “San Fernando Valley” to the more inspiring (and ludicrous) “Camelot”.

The secession movement is much less susceptible to the charge of “white flight” than it was. In the 1970s, during the last push for secession, the Valley was a white, middle-class bastion. Now the Valley's leaders may fit that stereotype, but 59% of the population is non-white (compared with 70% for the city as a whole). The only racial pitch the secession movement has made is to blacks in south Los Angeles, who have been losing ground politically to Latinos: let us go, say the secessionists, and you can keep your clout at City Hall.

As a rule of thumb, Californian voters tend to reject any ballot initiative they are uncertain about. That puts the onus on the secessionists to explain their case. One problem they face is that the most unpopular public service in the Valley—the famously bureaucratic Los Angeles Unified School District—will not be touched by secession; leaving it would require a new campaign (which Valley VOTE is already starting). More generally, most of the secessionists' energy has been devoted to maintaining their rage against Los Angeles, rather than creating a strong vision of what Camelot would be.

Lancelot, where art thou?

Although it would become the sixth-largest city in America (with its departure Los Angeles would drop to third, behind New York and Chicago), the Valley has few strong symbols of cityhood to rally round, such as sports stadiums, cathedrals or universities. Nor does it have many political heavyweights to lead its struggle. Gerrymandering during redistricting has meant that even some largely Valley seats in the California legislature are represented by people who live outside the Valley.

The governing establishment in Los Angeles is united in its opposition to the move. The mayor, James Hahn, and both his predecessor, Richard Riordan, and the rival he defeated in last year's election, Antonio Villaraigosa, have teamed up against secession. Religious leaders, philanthropists, the Chamber of Commerce and the big labour unions (whose members will serve as useful foot-soldiers in the door-to-door campaigning that lies ahead) have all come out against it. Between them, the opponents aim to spend $5m campaigning against secession, outgunning the $4m that Valley VOTE and its allies claim they will raise.

If the Valley's secession fails, it may still force Los Angeles to do something to make itself more responsive to voters. One option that may yet find its way on to the November ballot was floated this month by Robert Hertzberg, a Democratic member of the California Assembly from Sherman Oaks in the Valley. He wants to split up the city into nine boroughs, each including five wards of 82,000 people, with boundaries matching existing neighbourhoods and districts. Locally elected borough councils would control budgets and services and oversee smaller building projects. Truly city-wide problems would be overseen by a council made up of one representative from each borough council, rather than today's group of city-wide councillors.

Sheer uncertainty—the various commissions that have studied Valley secession cannot agree on what its financial impact would be on either side—may be the greatest enemy of the secession campaign. Mr

Hertzberg's scheme may strike the Valley's voters as a less risky way to create more responsive government than outright secession. They also know that the Valley is growing faster in both population and economic strength than the rest of the city. If the Valley does not leave LA, it may yet lead it.

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Prostitution

House of the rising farce

Jun 13th 2002 | NEW ORLEANS
From The Economist print edition

How many FBI agents does it take to shut down a bordello?

AP

Clear and pleasant danger

OUTSIDERS often have the wrong idea about New Orleans. Most residents conduct their everyday lives without visiting a voodoo priestess or a rowdy Bourbon Street bar, let alone a house of ill repute. Yet there's no denying the city's seamy past. Before it was razed in the early 20th century, the legendary Storyville neighbourhood was better known for its city-sanctioned brothels than as the birthplace of jazz.

Memories of those heady days returned when federal prosecutors disclosed their investigation, from April to September last year, of a brothel on a leafy, unassuming street. Members of Congress, impatient with the FBI's failures in fighting terrorism, have heaped scorn on the idea that its agents spent six months taping phone calls made by hookers. “I realise that it comes as an enormous revelation to the American public that there might have been prostitutes in New Orleans,” deadpanned Senator Patrick Leahy, a Democrat from Vermont. “I mean, who knew?”

The FBI's excuse for making it a federal investigation is that it believed the house was the centre of a nationwide prostitution ring. This is laughed at even more in New Orleans than in the capital. First established in 1994, the nicely named Knock 'n' Shop brothel was very much a family business, run in a friendly way by a mother-and-daughter team. It would be a stretch to say that today's New Orleanians merely raise a worldly eyebrow at such activities, but it seemed like a case for the local cops.

People in New Orleans also want to know why the madam, her mother, daughter and 12 other alleged prostitutes and co-conspirators face federal charges ranging from drug possession to racketeering, when the clients are getting off scot-free. It is reasonable to assume that many of the customers at the $300-an-hour brothel were powerful men. Their names have not been made public, but the list is rumoured to include prominent businessmen, lawyers and athletes.

No one in a position to prosecute these men has shown any interest in doing so. An acting government attorney, Jim Letten, insists there is no applicable federal statute. The city's top prosecutor, Harry Connick (the district attorney and father of the foppish jazz pianist), has declined to get involved in the government's case. Naturally, jaded New Orleanians have started to wonder who is protecting whom.

The local FBI office has tried to redeem its name, insisting for instance that the brothel investigation shut down briefly on September 11th, and was not an obstacle to anti-terrorism work thereafter. All the same, veterans of the city's *demi-monde* must wonder whether trouble abroad is always bad for business. When America entered the first world war, the secretary of the navy got the Storyville skin trade shut down because he feared losing sailors to venereal disease. Now history has repeated itself, even more farcically.

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New York's schools

Hitting the board

Jun 13th 2002 | NEW YORK
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A victory for New York's boss

AP

It was a big deal for Weingarten

CONSUMED by inexplicable grief over the death of John Gotti, the city's favourite celebrity mobster, New Yorkers may have missed an event far more significant and beneficial. After 13 pages of wallowing in the lonely death of the "dapper Don", the *New York Post* slipped in a report headed: "Mike Signs Teacher Contract". This concerned an offer made by Mayor Michael Bloomberg that the city's teachers couldn't refuse, and that may deliver its 1.1m pupils a brighter future.

The contract, which will raise teachers' salaries by as much as 22%, is not, as it might first appear, a case of throwing money at a problem that has patently not been solved by more money in the past. Nor is it evidence of Mr Bloomberg weakly abandoning, in the face of union pressure, one of the most entrenched negotiating positions held by his predecessor, Rudy Giuliani. Rather it is a shrewd piece of deal-making that bodes well for Mr Bloomberg's mayoralty.

How could Mr Bloomberg agree to a $1.14 billion pay-off to a municipal union—let alone trumpet it as a victory—in view of the city's looming $5 billion budget deficit? Because it has bought him a prize that has eluded every previous mayor since Ed Koch: control of the city's schools. New York's education politics traditionally resemble a blood sport; Mr Koch himself has heralded the deal, which was signed on June 12th, as "a miracle".

Much as Mr Giuliani made reducing crime the priority of his tenure as mayor, Mr Bloomberg entered office with his sights set on the city's ailing public schools. But the Board of Education—the body that (mis)manages the $12 billion schools budget—stood squarely in his way. The board was created in 1969 with seven members (two appointed by the mayor, one by each of the five borough presidents) to decentralise power and increase community participation. Since then it has become a breeding ground of paralysis and patronage, and has turned a blind eye to corrupt practices such as inflating standardised test scores and attendance figures to squeeze more money out of the state.

At first Mr Bloomberg took a Giulianiesque hard line and called for the board to be abolished completely. This was never likely, and was probably only a bargaining stance, since the power to abolish rests with the state legislature, whose Democratically controlled lower body has long protected the board, in part at the behest of their friends in the teachers' union.

Starved into submission by Mr Giuliani, the city's 80,000 teachers had seen their real pay plummet in comparison to their suburban counterparts. They had been working without a contract for 19 months. There was growing talk of a strike, and a deal suited Randi Weingarten, head of the teachers' union, who was able to persuade her allies in state politics to agree to mayoral control of the board.

Bills due to be passed by the state legislature and signed by the governor may give Mr Bloomberg more power over public schools than any other mayor in America. The board will live on, but now with 13 members, eight of them direct mayoral appointees. The schools chancellor, previously elected by the board, will be appointed by the mayor. The 32 elected community school boards, which were especially weak in poor neighbourhoods and often corrupt, will go. Democratic lawmakers stipulated that this new order will last only seven years (enough time for the Republican Mr Bloomberg to serve out two terms). But if the reforms are successful, they will surely survive.

Did Mr Bloomberg pay too high a price for his prize? Sol Stern of the Manhattan Institute, a think-tank, reckons the mayor got about 95% of what he wanted in the teachers' contract. It streamlines disciplinary procedures to get rid of bad teachers, and adds an extra 20 minutes to the working day. But it has left out Mr Bloomberg's proposals to reward merit and give better pay and better assignments to the most able (rather than the most senior) teachers. The generosity of the payment may also encourage the other big unions to aim higher in their negotiations with the city—inflating the budget deficit.

The other big question is what Mr Bloomberg will do with the schools. So far he has not revealed much. With luck, he has more ideas than he has so far let on.

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Another art-world scandal

Payback time

Jun 13th 2002 | NEW YORK AND LONDON
From The Economist print edition

The fine art of sales-tax evasion

AN UGLY panic is spreading around the Upper East Side. Meanwhile, the telephones in the offices of Robert Morgenthau, Manhattan's venerable district attorney, have been ringing day and night. Some of the city's richest people are apparently losing sleep over past sales-tax fiddles on works of art, and want to know if there's any chance of an amnesty.

On June 4th, when Mr Morgenthau indicted Dennis Kozlowski, the head of Tyco International, for allegedly evading more than $1m in taxes on fine-art purchases, the main significance seemed to be that it had forced him out of his job. The investigation was originally into Tyco's general tax affairs. Now it is clear that Mr Morgenthau, who brought a string of sales-tax cases against posh jewellers such as Bulgari and Cartier in the late 1980s, sees the indictment of Mr Kozlowski as the first step in a long investigation of New York's art world.

Sales taxes are the second-biggest source of revenue for most American states. New York has a combined city and state sales tax of 8.25%, one of the highest in the country. New Hampshire, Alaska, Delaware, Montana and Oregon do not levy any sales taxes (nor any use taxes, which are balancing taxes between sales-tax states to cover out-of-state purchases).

The indictment against Mr Kozlowski alleges that the tycoon bought art for his New York home, pretending it was going to his office in New Hampshire (thus evading any sales tax). His main art adviser, Christine Berry, is now co-operating with Mr Morgenthau. The suit alleges that several unnamed but prominent figures in the art world helped Mr Kozlowski. The art world maintains that the various John Does include Alexander Apsis and Vance Jordan, two Manhattan dealers, and Richard Green's London gallery. All the alleged participants, including Mr Kozlowski, deny any wrongdoing.

In some cases, the pictures were allegedly taken to New Hampshire, and signed for by Mr Kozlowski's assistant, before being immediately shipped down to Manhattan. In other cases, they did not even bother to go through that charade. According to the indictment, the dealer, who by law is responsible for collecting sales tax, simply asserted, falsely, “no tax shipped”.

Regardless of the truth of these allegations, which will be tested in court, some in the art world admit that similar shenanigans have taken place. “I know it does happen,” says Victor Wiener at the Appraisers' Association of America. Most private art dealers have only a few regular clients; crossing the borders of legality in order to satisfy their whims can be tempting. Others fiercely protest the industry's innocence. David Kusin, an art consultant in Dallas, points out that art dealers are subject to regular audits by tax authorities.

From the states' point of view, sales-tax evasion of all sorts is notoriously hard to monitor. The art world offers more opportunities than most, because many deals are private. For instance, evaders can make use of the tax-exempt status of non-profit organisations (such as museums) to avoid sales tax. Cheap works of art are now beginning to be sold over the Internet, where there is also no sales tax.

Some states have granted general amnesties on sales-tax evasion. In 1995 Connecticut raised millions of dollars by promising not to prosecute sales- and use-tax cheats if they paid up, with interest. New York's art world—both dealers and collectors—now seems keen to arrange another amnesty, specifically for works of art. Mr Morgenthau's nose tells him there is more to uncover. From Thomas Crown to Diana Brooks, fine art has attracted a better class of criminal. But it may be time for the dowagers of the Upper East Side to start unloading a few of those dusty old Renoirs. They may have some hefty legal bills to pay soon.

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Exotic pets

Tiger, tiger, buying right

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For every tiger in the wild, two are kept as pets in America

AP

They both bite

AS Mike Tyson ruminates on his trouncing by Lennox Lewis earlier this week, he may turn to feline company for consolation. Mr Tyson is the proud owner of one of America's 12,000 pet tigers. That figure, from the American Zoo and Aquarium Association, excludes the 510 tigers kept in zoos. Meanwhile, the World Wildlife Fund estimates that just 5,000-7,200 tigers remain in the wild. There are 4,000 pet tigers in Texas alone—more than are presently roaming free in India.

Buying a tiger is easy. There are plenty of websites where you can pick one up with a credit card. A baby Bengal costs around $1,000. Most are “surplus” cubs, bred by zoos, or their descendants. These pets are not covered by the 1973 Endangered Species Act, which only applies to animals taken from the wild.

So the regulatory burden falls on individual states. The laws for the possession of exotic pets vary from one state to another; they are full of loopholes and are usually poorly enforced. Nineteen states ban private ownership of tigers. The rest either require permits or leave regulation up to local authorities. Last year Texas passed a law enabling its 254 local counties to outlaw pet tigers. Similar laws may be enacted in Ohio, Washington and New York.

Enforcing such bans, though, is another matter. The owners of exotic beasts are unlikely to surrender their pets voluntarily. And even if the police had the wherewithal to capture illegally owned tigers, what would they do with them? Zoos say they already have more tigers than they can take, and repatriation to Asia is out of the question.

Where bans exist, wily owners will often claim they are “licensed exhibitors”, which puts them under the Department of Agriculture's jurisdiction. In recent years the department has become somewhat more aggressive in inspecting such exhibitors, prompting howls of fury from tiger owners.

Nevertheless, a little more inspection would be no bad thing. Over the past ten years at least 16 Americans have been attacked by pet tigers, five of them fatally. But typically it is the animals themselves who suffer most. Some gormless owners are surprised to see their cute little cub transmogrify into a 400lb (180kg) eating machine that devours $200-worth of meat every week. Sometimes their claws are removed to make them safer. Few American vets are qualified to treat tigers. Worst of all, it seems that some animals are being bought just so they can be slaughtered for their skins, which fetch up to ten times more than a live animal. They'd surely be better off taking their chances in the wild.

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Lexington

The CEO presidency

Jun 13th 2002
From The Economist print edition

George Bush's Clintonian drift into crisis-management

REMEMBER the CEO presidency? Remember all the talk about how America's first president with an MBA would set broad “strategic” goals while his loyal and leak-free “board” of seasoned businesspeople would decide how to implement them? And remember all the sneering comparisons with the chaotically unprofessional Clinton administration?

Well, the chaos is back. An administration that was supposed to run as smoothly as clockwork has recently been clattering from crisis to crisis, with the FBI and CIA waging a war of leaks against each other in the press, with officials issuing endless warnings of imminent terrorist attacks, and amid a general sense that things are drifting out of control.

George Bush was frequently tired and grouchy on his recent trip to Europe, hardly the best way to reassure nervous allies. Then Andrew Card, Mr Bush's chief of staff, added to the sense of gloom in the White House over the impending departure of Karen Hughes, the president's communications director, with a foolishly frank interview in *Esquire* magazine. One of the keys to the administration's success so far, he argued, has been the balance between the ideological Karl Rove, senior adviser to the president, and the more pragmatic Ms Hughes. Her departure could, he implied, tilt the White House in a dangerously right-wing direction.

The obvious reason for such gaffes is exhaustion. Visitors to Washington are often impressed by the size of the president's entourage. But Mr Bush's inner circle—the people he trusts to offer advice and take important decisions—is no bigger than a dozen. Over the past couple of months the inner circle has had to deal with a relentless barrage of international problems, involving some of the world's most intractable conflicts (Israel v Palestine; Pakistan v India; al-Qaeda v civilisation) as well as its most dangerous weapons. No wonder there is an air of exhaustion hanging around the White House.

There is an air of exhaustion hanging around the White House. This can lead to gaffes

This air of exhaustion hangs particularly heavily around the president. Mr Bush has never been noted for his appetite for hard work. He likes to take long breaks for exercise during the day and to tuck himself in bed by 10pm. He also likes to focus on a couple of big issues of his own choosing rather than dealing with mess and confusion. Add to this the fact that he did not exactly come to office overburdened with knowledge of foreign affairs and you can see why he sometimes looks a little grouchy.

But there is more to the administration's problems than this. There is a failure to plan ahead. Mr Bush's decision to create a new Department of Homeland Security was driven by political expediency rather than strategic planning. He resisted the idea of creating a separate department for nine months. A month ago his staff were lobbying Republican senators to vote against the idea. He changed his mind out of desperation—because the revelation that the FBI and CIA had ignored evidence that might have prevented September 11th was undermining the country's confidence in its institutions. A CEO president would have got to work redesigning the Washington bureaucracy months ago. Mr Bush is allowing one of the most important government changes in 50 years to be shaped by scandal and spin.

Next, consider an area that should be close to the heart of this Harvard Business School graduate: corporate reform. So far the administration's proposals for curing Enronitis have been lame. The White House is sitting on its hands while special-interest lobbyists are busy neutering legislation on Capitol Hill. Such paralysis is bad for the economy. In the past fortnight the heads of both Goldman Sachs and IBM have given warning that doubts about corporate honesty are depressing the stockmarket. It is also bad for the administration. Mr Bush had a chance to show that he is tough enough to force his fellow CEOs to put their houses in order. Now it looks as if he is more interested in avoiding hard questions about Dick Cheney's spell as head of Halliburton or his own ties to dubious energy chiefs.

All roads lead to Baghdad

To Mr Bush's harshest critics, this failure to plan ahead is part of an increasingly dangerous penchant for short-termism. His rapid surrenders on free trade are clearly part of that pattern. Hawks are now also worried about Iraq. In the months following his “axis of evil” speech Mr Bush gave the impression that he was planning to liberate Iraq from Saddam Hussein. And he seemingly reaffirmed that strategy in a speech at West Point, arguing that American foreign policy is now based on a doctrine of pre-emptive intervention against its ghastliest enemies. But military strategists are whispering that Mr Bush is having second thoughts as he learns more about the sheer scale of the operation—that it could take a quarter of a million troops to remove Saddam, that there could be bloody street-by-street fighting, and that installing a new regime could be the work of years.

The good news for Mr Bush is that he is adapting surprisingly well to the Clintonian world of crisis-management. His *volte face* on homeland security may have been disingenuous, but it seems to have worked. That and the news of the capture of the dirty bomber, which Mr Bush's people have shamelessly milked, has distracted attention from the debate about the failings of the intelligence services (where, again, there seems to be no administration strategy to reorganise the system).

But such seat-of-the-pants policy-making is fraught with problems. For the moment Mr Bush is in danger of remaining on the defensive, dealing with events rather than dominating them. In its own grisly way, another terrorist attack could alter that perception. Barring that, the hawks may be right: the future of the Bush presidency depends increasingly on Iraq. If Mr Bush follows through on his promise to topple Saddam Hussein, he will regain control of politics. If he backs down, Clintonian crisis-management may be the order of the day until 2004.

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Brazil's economy

The 685 billion reais question

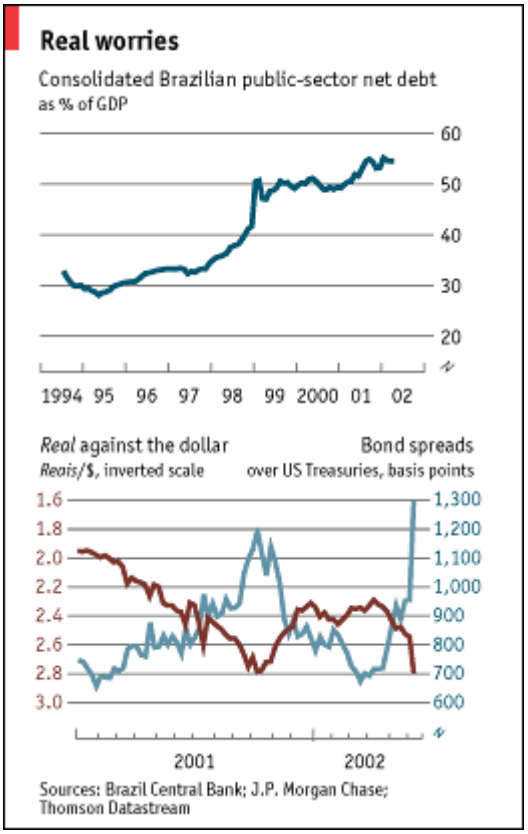
Jun 13th 2002 | SAO PAULO
From The Economist print edition

Will Brazil be forced to default if the opposition win October's presidential poll?

Get article background

GEORGE SOROS, a famous investor and currency speculator, offers Brazilians a stark choice in October's presidential election: vote for Jose Serra, the candidate of President Fernando Henrique Cardoso's centrist coalition, or expect an Argentine-style crash in which Brazil would be forced to default on its 685 billion *reais* ($245 billion) of public debt. Last weekend, Mr Soros told *Folha*, a Sao Paulo newspaper, that the election of Luiz Inacio Lula da Silva of the left-wing Workers' Party, who heads opinion polls, would make investors so fearful of a possible default that they would stop financing Brazil, fulfilling their own prophecy. Only a victory for Mr Serra would banish such fears, he said.

In the past two months, such worries have caused the *real* to plunge, while the "spreads" on Brazil's debt (the premium investors demand to compensate for risk) have soared (see chart). New polls this week showed Mr Serra consolidating his second place, increasing the chance that the election will end in a run-off ballot between him and Mr da Silva. Nevertheless, the market panic quickened: on June 12th, Brazil's risk premium reached 12.96%, its highest level since 1999.



Mr Serra and Mr Cardoso have themselves been telling voters that Brazil could face Argentina's fate "if an incompetent president were elected". Though Mr da Silva now pledges to honour all financial obligations, he has only recently come out emphatically against any sort of default. He and his advisers continue to give contradictory signals over how resolutely they would pursue sound finances and low inflation, prompting investors to wonder if a Lula government could pay its bills, even if it wanted to. Two soft-left presidential contenders also provoke doubts: Ciro Gomes with talk of a "voluntary" debt restructuring and Anthony Garotinho with extravagant spending promises.

The opposition candidates retort that the government is engaged in "economic terrorism", fomenting panic to cling to power. They also blame the market turmoil on a recent, unexpected, decision by the Central Bank to require investment funds to revalue their portfolios each day according to their market worth.

But there seems little doubt that behind the panic lie electoral uncertainty and the dark cloud of Brazil's public debt. Since Mr Cardoso took office in January 1995, the public debt has risen from 30% to 55% of GDP, even though the government raked in almost $100 billion from privatisations. Mr Cardoso incurred debts trying to prop up the *real*, until its devaluation in 1999. But the debt is also partly due to his recognising enormous hidden liabilities left by his predecessors, so-called "skeletons" which have so far added ten percentage points to the debt ratio. Another large chunk was incurred by free-spending states and cities, some opposition-run.

Even if the pre-election turbulence worsens, Brazil should be able to continue paying its bills at least until the new government takes over next January, says Marcelo Carvalho, an economist at Bank of America. About 100 billion *reais* of debt is due for repayment by the end of the year, but Brazil's Treasury already has half that much in cash at hand. And if other sources of finance dry up, Brazil could turn to the IMF: it has not yet drawn down $10 billion from a loan agreed last year.

If a public debt of just over half of GDP proved unbearable for Argentina, will it also be for Brazil?

The real worry is what happens to economic policy under the next government, which will face a heavy burden of debt expiring in its first few months. If a public debt of just over half of GDP proved unbearable for Argentina, will it also be for Brazil? There are several reasons to hope not. Argentina's debt was almost all in dollars, so default was a concomitant of the collapse of its currency's peg to the greenback. But only a quarter of Brazil's debt is dollar-linked. And while Argentina borrowed mostly from fickle foreign investors, about three-quarters of Brazilian debt is held by more pliable domestic institutions. However, credit-rating agencies do worry that Brazil's foreign debt is high compared with its export earnings.

Edward Amadeo, a former senior finance official, reckons Brazil's debt burden would remain manageable under four conditions: that the next government maintains the current fiscal surplus (before interest payments) of 3.5% of GDP; that the economy grows at least 3.5% annually; that the *real* steadies; and that real interest rates do not rise above their current 9%.

Were investors to lack confidence in the new government, they could send the *real* plunging and interest rates soaring, making the situation unmanageable. But even if default is avoided, the next government will continue to be hobbled by high debt-interest payments (9% of GDP this year). And the state's demand for credit keeps interest rates high, stifling the private sector. The only way to get investors to lend at lower rates is to continue the long slog towards modernising the economy while maintaining a tight grip on the public finances and controlling inflation. If Mr da Silva did win, and if investors gave him a chance, he would have little alternative but to set out on this long, hard road.

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Crime in Mexico

Critical threat

Jun 13th 2002 | MEXICO CITY
From The Economist print edition

Police reforms have yet to stop the rise in crime

SO DANGEROUS is crime in Mexico that the United States' government considers the country's capital to be a “critical-threat environment”, bracketing it with such places as Kabul and Johannesburg. An alarmist judgement? Since most crimes in Mexico go unreported, official statistics reveal little. But local analysts and ordinary Mexicans are agreed that crime is rising steadily. It has started to become an economic problem as well as a political issue. Almost every week, President Vicente Fox, or a minister, unveils an eye-catching new crime-busting measure in front of the cameras. But despite some victories, Mr Fox's government is struggling to get on top of the problem.

Crime, and violent crime in particular, began to rise after a deep economic recession in 1995. It then seemed to level off as the economy recovered. But last year the economy again entered recession. In a survey published last month by the Civic Institute for the Study of Crime (CISC), a government-funded think-tank, 75% of the respondents said they thought that crime increased in Mexico last year. In the capital, 39% reported that a member of their household had been a victim of crime in the past year. According to CISC, crime costs Mexico more than $5 billion a year. It damages tourism and imposes an extra cost on foreign investors.

Kidnapping grabs the most headlines. Officially, there were 732 kidnaps in Mexico last year. But the true figure may have been up to five times as many, according to Eduardo Gallo, a businessman whose daughter was kidnapped and killed in 2000. Not all of the victims are wealthy: ransom demands can be for as little as $500, while “express kidnappings”, in which the victim is held for a day or two and forced to withdraw money from a cash machine, can involve a mere $150.

Mr Gallo's case is unusual: he single-handedly led an investigation into his daughter's abduction, and seven of the gang responsible are now in prison. The families of most kidnap victims, fearing reprisals, do not even report the crime.

Mexicans have turned to crime in such numbers because their chances of being caught, let alone punished, are small. In an average year, only 7% of murders are cleared up, for example. And those who are caught are quite likely to be acquitted, or punished only lightly. Inefficiency is partly to blame, but corruption, in the police and the judiciary, more so.

Marcelo Bergman, a crime researcher at CIDE, a Mexico city university, recently surveyed a sample of the country's prison population. He found that 67% of respondents believed that if they had had the money to bribe the police, they would have got off. And 44% believed the same about the country's district attorneys. Last month, a United Nations special rapporteur on human rights in Mexico claimed that up to seven out of ten federal judges were corrupt. Some policemen are themselves engaged in crime. Extortion is a routine way of topping up salaries. The police in some states, such as Morelos, near the capital, have become notorious for their active participation in kidnap gangs.

Corruption of this sort flourished under the long rule of the Institutional Revolutionary Party (PRI). Mr Fox, who defeated the PRI in 2000, promised to attack crime by reforming the police and prosecution system. His government is setting up a national database, which should at least prevent convicted criminals from joining the police. It has also formed new police units, such as one against kidnapping. These elite units are hand-picked and better paid.

They have had some successes. Last week, police arrested Pedro Barragan (alias “the godfather”), the leader of a notorious kidnap gang. Earlier, they had broken up the “anthrax” gang, another kidnap ring. And a new anti-drug police unit has won the trust of American officials.

But there is a long way to go. Alejandro Gertz, the minister for public security, admits that corruption remains endemic in the police; he calls it both “structural” and “a cultural problem”. To make matters worse, the judiciary has no tradition of independence. Under the PRI, the judges, like the Congress and the state governors, took their orders from the executive.

But as well as offering potential solutions, democracy has in turn brought a novel problem for law enforcement. In law, the federal government has limited powers over the states. Kidnapping, for instance, is not a federal crime. Penalties vary from 40 years imprisonment in one state to as little as two years in another. The government is encouraging states to work together more closely on crime, and to streamline penalties. But that will require forging new political agreements. Meanwhile, crime looks set to continue on its upward trend.

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Cuba's economy

Bitter pills

Jun 13th 2002
From The Economist print edition

Fidel Castro is to shut half his sugar industry

COMMUNIST Cuba is probably not on the list of al-Qaeda's terrorist targets. But such is its dependence on the dollars and euros brought by foreign holiday makers that the worldwide slump in tourism after September 11th has hit its economy especially hard. The first sign of strain came in April when Venezuela suspended oil shipments after Cuba failed to meet its payments. Last week, in an effort to round up extra foreign exchange, Cuba's government announced a big increase in the prices of goods at the islands' dollar stores. Now Cuban officials have quietly revealed plans to close almost half the state-owned sugar mills.

That is the most dramatic economic move since the decision by Fidel Castro, Cuba's president, to allow the use of dollars on the island in 1993. Officials had been urging reform of the antiquated sugar industry for years. Mr Castro balked for political reasons. Sugar was the mainstay of Cuba's economy for centuries. It still employs 400,000 workers. But the sugar mills are in poor condition; almost all date from before the 1959 revolution. Production peaked in 1989 at 8.1m tonnes; last year it was only 3.6m tonnes. Now, perhaps 71 of the 156 mills will go, and thousands of jobs with them.

Before the collapse of the Soviet Union, Cuba could barter its sugar with its communist allies at preferential rates in return for oil and other essentials. Now it must sell its sugar on the world market, where it is worth 5 cents a pound. Cuba earned just $430m from its latest sugar harvest, down from perhaps $5 billion in 1990. And its inefficient mills guzzle oil.

Rather than sugar, Cuba now relies on tourism and remittances for most of its foreign exchange. But despite investment in new hotels and resorts, in the first quarter of this year tourist arrivals were 14% below the same period last year, according to official figures. Remittances from Cuban-Americans in the United States, worth between $500m and $800m in past years, have fallen too.

Now the government intends to take a bigger slice of a smaller cake of remittances. At the dollar stores, petrol is to go up from $2.85 to $3.99 per gallon, while electrical goods will go up by 30%. This will be unpopular: local salaries of around $10-15 per month cover only the barest essentials (mainly subsidised food). Many Cubans depend on money from abroad for everything else.

Mr Castro had little choice, if he is to assure fuel supplies and prevent power cuts. He is fortunate that his friend Hugo Chavez, Venezuela's president, survived a coup attempt in April. Since October 2000, Venezuela has been supplying a third of Cuba's oil imports, on credit and at 2% interest. In November, it rescheduled previous payment arrears. But Cuba quickly fell into arrears again; by April, these totalled $63.4m. Officials are now negotiating a fresh agreement, but this time Venezuela is pressing harder for payment.

The government's hopes are now pinned on tripling tourist numbers, to 6m by 2010. Many of them would have to be Americans. That may explain Mr Castro's efforts to be friendly to the United States. He allowed Jimmy Carter, a former American president, to meet dissidents and speak freely on television during his visit to the island last month. Cuba has bought food worth $90m from American companies, and been helpful over the United States' use of Guantanamo as a prison.

But the Bush administration isn't biting—at least not until after the president's younger brother, Jeb, is safely re-elected as governor of Florida in November. Meanwhile, Mr Castro shows no sign of loosening his grip on the island's politics. On June 12th, he led a march of 1m people, organised by the government in support of constitutional amendments which would relieve the National Assembly of its duty to debate a dissident petition calling for a referendum on free speech and elections. If Cuba is in for a summer of

fuel shortages, many more such marches may follow.

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Colombia's conflicts

Rebel mini-state

Jun 13th 2002 | SAN VICENTE DEL CAGUAN
From The Economist print edition

Where the gun tries to vanquish the vote

WRITTEN in clumsy block capitals, the letter handed to Omar Varon, the mayor of the village of El Doncello, began with the pious hope “that you are in good health and surrounded by your loved ones”. Then it ordered him to leave within 24 hours—or “be declared a military target”. It was one of dozens sent over the past fortnight by the Revolutionary Armed Forces of Colombia (FARC), the country's largest guerrilla army, to local officials in the south of the country. The apparent aim: to expel government authority from the departments of Caqueta, Putumayo and Huila, thus starting to recreate a larger version of the enclave which President Andres Pastrana let the FARC run for three years until peace talks collapsed in February.

The threats are working. After one mayor in Caqueta was killed, 22 others fled to Florencia. Courts have closed in ten small towns. In Huila, six mayors have resigned; a score from Caqueta say they will do the same unless they get a government guarantee of their safety.

Gilberto Toro, who heads Colombia's mayors' federation, says that the FARC's action is a response to the victory of Alvaro Uribe in last month's presidential election. In April, the guerrillas tried to kill Mr Uribe, who promises to expand the army and has set firm conditions for a resumption of talks.

The challenge for the government is to preserve local democracy, and prevent the FARC from setting up its own mini-state. Armando Estrada, the interior minister, has refused to accept the mayors' resignations. Instead, he has promised bodyguards and armour-plated cars to keep the officials safe. But many mayors are unimpressed. “If I don't resign, I'll become just another corpse,” said Mr Varon, after being airlifted from El Doncello.

The FARC controls much of the countryside in the three departments. Even in San Vicente, a cattle town of 20,000 people and the largest town in the former guerrilla enclave, the army's control is fragile. By day, soldiers patrol the sun-scorched streets. But the town has been without electricity since a guerrilla attack on its power station three weeks ago, and without newspapers because of FARC roadblocks. San Vicente's mayor, trailed everywhere by two police bodyguards, is staying for now. But the town councillors have all fled. Can Mr Uribe, who is due to take office in August, coax them back?

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India and Pakistan

Do we have a deal?

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From The Economist print edition

AP

De-escalation has begun on the subcontinent, largely thanks to intense American pressure. But the process could easily be derailed

Get article background

THEY are small steps, but they turn India around. This week India ended a five-month ban on Pakistani civil aircraft entering its airspace, withdrew its navy from waters near Pakistan and named, though did not send, an ambassador to Islamabad. A million Indian and Pakistani soldiers continue to menace each other across their common border, but for the first time since December, when Pakistan-based terrorists attacked its parliament, India is lowering the pitch of its fury. Donald Rumsfeld, the American defence secretary, who visited India and Pakistan this week as part of an international effort to head off war between nuclear powers, called India's measures “useful” but said that tensions remain high.

The peace process, if it is to continue, must pass through two phases. The first deals mainly with procedure, the second with principle. Each has its pitfalls. If they are overcome, India and Pakistan might finally end the feud that began when they became independent in 1947.

Phase one is a trade: Pakistan is to end support for terrorists fighting Indian rule in Kashmir, a Muslim-majority state that is divided between the two countries. India is to back off from its threat of war and, eventually, to resume talks with Pakistan on Kashmir, the main cause of their dispute. Both sides accept this blueprint, but it could easily be botched in execution. Avoiding that was the main object of Mr Rumsfeld's trip this week. It is not yet clear how successful he was.

Politics encourages dawdling. For General Pervez Musharraf, shutting down the anti-Indian militancy means discarding his main method of keeping alive Pakistan's claim to Kashmir. He is unwilling to do it without significant Indian concessions, and his country is full of vengeful zealots who will refuse to do it at all.

When American mediators call India a “great democracy”, they mean that they are not sure who is in charge. Their rounds in Delhi generally take in the prime minister, the national security adviser and the foreign minister, all moderates, but also the unpredictable defence minister, George Fernandes (pictured above with Mr Rumsfeld), and the hawkish home minister, L. K. Advani, who has his own ideas about Pakistan. His ministry has opposed making any gestures to Pakistan until it shuts down completely the machinery of terrorism. For their part, the armed forces are itching for a fight with Pakistan. If the next

terrorist strike is spectacular enough, they could get their way.

But the moderates are making the decisions, at least for now. They have acknowledged that infiltration from Pakistan is down and have started a “calibrated” response. The process would probably survive even another attack. Ending terrorism “is very difficult to achieve on the ground because the disease has spread over 20 years,” says Jaswant Singh, India's foreign minister. The government is considering American offers to help monitor electronically (not with troops) the line of control (LoC), which divides Kashmir. It appears to set store by American assurances that General Musharraf is serious about doing everything he can to stop terrorism.

If Mr Rumsfeld expected India to offer additional gestures to encourage him to do it quickly, he was disappointed. America wants further de-escalation, starting perhaps with a pullback of the airforce from the border and home leave for soldiers there. But India made it clear that it would do no more until Pakistan reduces infiltration further and starts dismantling militant camps. Much of its force will remain in place at least until elections in Kashmir this autumn.

Pakistan's ultimate prize is a dialogue on Kashmir, which is where arguments on principle will come in. Since its founding as the homeland for South Asia's Muslims, Pakistan has seen Kashmir as stolen property. India's abuses of democratic norms and human rights in the state add to the indignation. Multi-religious India sees no reason to give up a state that acceded to it legally. It regards the discontent of ordinary Kashmiris as an internal matter. Talking to Pakistan will change none of that.

If terrorism loses its bite, democracy and diplomacy will be the weapons in the duel over Kashmir. India wants to cure Kashmiri separatism with elections, which it hopes will produce a popular government willing to negotiate a political deal short of independence (which most Kashmiris want) or accession to Pakistan.

Diplomacy is now Pakistan's main tool for stopping India consolidating its hold over Kashmir. Pakistan counts it a victory that the nuclear panic has drawn third parties into the dispute. The crisis “has put Kashmir on the international agenda in a way that it has never been before,” said Richard Armitage, America's deputy secretary of state.

In the past this would have rattled India, which regards Kashmir as a bilateral issue. But India and the United States have become firm allies in the fight against terrorism. Mr Rumsfeld's remark in Delhi that al-Qaeda may be operating near the LoC can only cement the friendship.

America and other outsiders are unlikely to help Pakistan much on Kashmir. They have neither the power nor the inclination to force India to surrender large additional chunks of the state. At best, they can pressure India to sit at the table and to treat its own Kashmiri citizens decently enough so that General Musharraf can claim to have protected their rights. Perhaps Pakistan is ready for this. “If India addresses the alienation of the Kashmiri people, Pakistan will be perfectly happy to live with the territorial status quo,” says Rifaat Hussain, a Pakistani academic now at Stanford University. That might be a formula for a lasting peace.

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Afghanistan

A scramble

Jun 13th 2002 | KABUL
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The loya jirga convenes at last, to authentic confusion

A jirga or a fix?

AFGHANISTAN'S first traditional council in decades got off to a bumpy start this week. More than 1,500 delegates, 200 of them women and including teachers, engineers, aid workers, provincial governors, political leaders and former *mujahideen*, came from all over the country to participate in the *loya jirga*, supposed to elect a head of state and a government to replace Hamid Karzai's interim administration. Bearded tribesmen in huge buttercup yellow turbans mingled with men in suits and women delegates in a vast carpeted tent set up in Kabul Polytechnic. In between sessions, all gathered for discussions on cushions in side tents. In spite of their differences, they shared a common desire: to speak and be heard.

Political wrangling, however, had already marred the meeting before it even started. The main argument was about the role Zahir Shah, the 87-year-old former king, should play in the next administration. Many, especially among the Pushtun majority, wanted to see the king become the next head of state. Powerful Tajiks—who make up a small part of the population but dominate the current interim administration—were strongly opposed to the idea, however. They instead supported Mr Karzai, their own Pushtun ally, for the top position.

A Karzai roll quickly developed. A former rival, ex-President Burhanuddin Rabbani, withdrew his candidacy, while Mohammed Qasim Fahim, the Tajik defence minister, also pledged his support for Mr Karzai. After a tense 24 hours—and a telling visit from American diplomats—Zahir Shah announced that he would not be a candidate for the post and strongly endorsed Mr Karzai as president.

Shortly after the king formally opened the *loya jirga* one day late on June 11th, the interior minister, Yunus Qanooni—one of three powerful Tajik ministers—announced his voluntary resignation “in the interests of peace”. This was greeted with loud applause and should help to answer complaints about the ethnic imbalance in the current administration. “This was a first step, the future government will have to be more inclusive,” said Abdullah Abdullah, the interim foreign minister, who is also a Tajik.

Many delegates are unhappy about these backroom dealings. “This is not democracy, it's a rubber stamp,” said Sima Samar, the minister for women's affairs. Most of the serious negotiation about the composition of the future government is taking place behind closed doors. But since any proposal has nonetheless to be approved by the *loya jirga*, there could be surprises. There was surging impatience during a ceremonial opening that did not allow for any speeches from the floor. When the first working session finally began the following day, and delegates were invited to put forward candidates for chairman of the *loya jirga*, queues formed at the microphones as people lined up to raise objections. The election of a chairman and his deputies took all day, further postponing the choice of a new leader.

It remains to be seen whether the delegates can make their voices heard. The preparation of the *loya jirga* was accompanied by reports of intimidation and bribery. Now that it has started, there are complaints about the presence of powerful warlords and others who have gained entry without being elected. “You said no one could be a candidate who is a murderer or a criminal,” said an elderly turbaned delegate, Safar Mohammed. “There are a lot of military people in this meeting. I do not know if this is a military council or a *loya jirga*,” he said, to sustained applause. UN officials ineffectively muttered that plain-clothed intelligence police had swamped the gathering and could be an intimidating presence. For all its shortcomings, though, most Afghans still seem to consider the *loya jirga* as a step in the right

direction. Only six months ago, their country was in the midst of an international confrontation and a civil war. “That we are gathering here is an amazing tribute to national unity and reconciliation,” said one bemused delegate.

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India

Rocketman

Jun 13th 2002 | DELHI
From The Economist print edition

India's proposed president has broad appeal

Get article background

THE role of India's president is to be, among other things, a walking mission statement for the country. The incumbent, who is expected to retire in July, stands for merit over caste: he is the first Dalit (formerly, untouchable) in the job. The successor proposed by the ruling coalition suggests new slogans: national assertiveness and religious harmony. A.P.J. Abdul Kalam would be India's third Muslim president. What makes him politically sexy is that he is also touted as the father of India's nuclear bomb (though he is a rocket scientist rather than a nuclear one).

Mr Kalam seems the perfect antidote to accusations that India's ruling Hindu nationalist party failed to protect Muslims from massacre in the western state of Gujarat earlier this year. No doubt, a subtle dig is also intended at Pakistan, which has plenty of missiles but few minorities. The message to other countries? Perhaps, that India can stand up for itself. “The emergence of India as a self-reliant country in the field of guided missiles upset all the developed nations of the world,” Mr Kalam wrote in his autobiography, “Wings of Fire”.

It is hard for opposition politicians to object to a national hero as president, though many would like to. The president's duties include deciding which party to ask to form a government after an election, a role that confers substantial power in an era of fragmented parliaments. Opposition parties fear that Mr Kalam lacks the political experience or constitutional expertise to stand up to the ruling coalition. But he will not have to campaign much. The voters are the combined elected membership of parliament and state legislatures. That mission statement should see him through.

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Japan

Ishihara's waiting game

Jun 13th 2002 | TOKYO
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As Koizumi falters, Tokyo's governor weighs his chances

Bigger plans than Tokyo?

“THEY are rich but unhappy.” Shintaro Ishihara sums up the 12m people he serves as governor of Tokyo. In this respect, Mr Ishihara says, they are little different from the 115m Japanese who live outside its dominant city. And although the 69-year-old ex-novelist currently has no authority over the rest of Japan and its troubles, many onlookers suspect that he will in time.

Even before Junichiro Koizumi's popularity began to fall early this year, those who doubted his political longevity had started to speak of Mr Ishihara as a candidate to succeed him as prime minister. In part, that is because Mr Koizumi's own personalised approach to politics may have paved the way for populists such as Mr Ishihara, who once sat in parliament for the ruling Liberal Democratic Party (LDP), only to turn round, denounce the party, and strike out on his own.

The governor's brand of provocative nationalism would also give him an edge should Mr Koizumi's reform pledges fall flat and leave voters in search of a simple new message. But perhaps the best reason for the speculation about Mr Ishihira's future, apart from his own ambition, is the pitiful performance in parliament of the minority parties. Their failure has allowed this local governor to emerge as a force of opposition on the national stage.

Mr Ishihara has behaved like an opposition leader in three ways. First, he has used his pulpit to make pithy criticisms of the Koizumi government, from its failure to defend Japan's reputation to its willingness to compromise on economic reforms. Second, he has offered policies that point up differences between himself and the prime minister. For example, he tried to tax banks on their local activities. Although the courts have now overturned the tax scheme, the move let the governor look tough on banks at a time when Mr Koizumi's financial regulators were coddling them through half-hearted audits.

The tax row also drew attention to complaints by Mr Ishihara and other governors about the central government's dominance over tax and spending decisions, a line that holds obvious advantages for an independent politician with national ambitions. While opposition MPs whinge about editors who ignore their campaigns, the stylish and demagogic Mr Ishihara has no trouble getting his proposals an airing.

Hence the third way in which Mr Ishihara functions as the Koizumi government's opposition: he is one of the few politicians with a realistic chance to succeed him. Rumours that he would soon try to do so heated up in April, after the governor attended a dinner meeting with Mr Koizumi's rivals in the LDP. But Mr Ishihara has remained coy about becoming prime minister and says that his goal for now is to win re-election as governor next April, a race he should win easily.

Playing the waiting game makes sense, given the difficulty of supplanting Mr Koizumi directly. To do so, the governor would have to give up his post and run for parliament. Since re-integrating himself into the LDP would destroy his maverick image, the best way to do this would be by forming a new party from splinters of the LDP and its rivals.

That, however, is just what Mr Koizumi himself would do if he were to call a snap election. He and Mr Ishihara would therefore be forced to fish in the same pond for party defectors. So Mr Ishihara may prefer to wait for Mr Koizumi's ruling coalition to unseat the prime minister, then form a new party to challenge the LDP. “Koizumi has to go first, he can't just take over,” says Shigenori Okazaki, a political analyst at UBS Warburg in Tokyo.

If Mr Koizumi falls, how might Japan's public greet an Ishihara bid? The governor's nationalist rhetoric, especially his barbs at China and the United States, brings him most attention. When *The Economist* spoke to him last week, Mr Ishihara lashed out at both China (for stealing Japanese technology) and the United States (for asking Japan to limit dual-use technology sales to China). Most of his complaints about other countries are economic. He wonders why Japanese institutions invest so much in American bonds, and would like to use Japan's security ties with the United States to bargain for economic concessions. This is a very far cry from making him a nationalist such as Austria's Jörg Haider or the Netherlands' late Pim Fortuyn: but in a country with Japan's historical ghosts, a politician who speaks out against foreigners is a rarity.

An Ishihara government would annoy some of Japan's neighbours. Not all would welcome his plans to expand the navy. But most observers expect him to tone down military talk as prime minister and turn instead to economic populism to appeal to a broad range of voters.

Mr Ishihara draws three main distinctions between his own economic approach and Mr Koizumi's. He complains that Mr Koizumi has been too soft on the banks (“Let them fail,” he says succinctly). He says that structural reforms and reflationary policies can easily coincide; whereas Mr Koizumi is keen to restrict construction firms, Mr Ishihara is brimming with ideas for new infrastructure projects. And he does not think Mr Koizumi's proclaimed structural reforms go far enough (or at least fast enough) in practice.

Overall the governor and the prime minister share a defect. Both talk tough on what ails Japan; neither has a political way of implementing the necessary changes. That, however, seems not to deter the governor's many admirers.

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Vietnam

Land and freedom

Jun 13th 2002 | HANOI
From The Economist print edition

Vietnam's land shortage is leading to all manner of shenanigans

ANYONE who dares to defy Vietnam's repressive security services and mount a public demonstration must have a compelling reason. And the reason is almost always the same: land. The small knots of protesters with placards who gather periodically outside government offices are usually complaining about a corrupt official who has seized their property. At least one such petitioner has even set himself on fire. In the central highlands, the continuing allocation of land to immigrants from the lowlands has prompted the country's worst unrest since the end of the Vietnam war. A shortage of land is hampering small businesses. Land, it seems, lies at the heart of Vietnam's most pressing problems.

It is easy to see why. The country is roughly twice as densely populated as most of its neighbours in South-East Asia. The best land, in the fertile valleys of the Mekong and Red rivers, is more crowded still. Historically, the rulers of nearby Thailand and Cambodia have struggled to populate their territory, while the rulers of Vietnam have struggled to find territory for their population. The more recent past has further complicated matters. The famine that followed Vietnam's experiment with collectivisation in the 1980s generated a government obsession with self-sufficiency in food. Communist bureaucracy makes the process of buying and selling land complicated and corrupt. And the country's faltering transition from a centralised to a market economy has left the status of landowners ambiguous.

Officially, of course, no one in Vietnam owns any land. It all belongs to the state. In the 1990s, in an effort to make farmers feel more secure, and hence more productive, the government began handing out long-term land-use rights. By the end of the decade, formal, tradable title had been granted for over 90% of Vietnam's lowland farms. At the same time, in a further effort to maximise harvests, the government imposed tight restrictions on the right to build on farming land.

In the cities, meanwhile, the government had no similar incentive to hand out formal property rights. Most urbanites continued to live in apartments originally assigned to them by the veterans' association, their workplace or some other government agency. The past decade of market reforms, however, has made many people rich enough to buy their own houses. What with limited land for construction, a fast-growing population and large-scale immigration from the countryside, there is a desperate shortage of urban housing. Town-dwellers have to deal in the unregulated and easily-manipulated “informal” market—without the benefits of legal title. What is more, land constitutes one of the country's few attractive investments, in comparison to its shaky banks and a stockmarket composed entirely of state-owned firms.

Hence the frantic speculation. Customers at news-stands have been known to fight over copies of *Buy and Sell*, a specialist property newspaper. Those lucky enough to work in the planning department peddle information about the areas the government has slated for development. Stories abound of corrupt bureaucrats diverting highways to raise the value of their own land. The more cunning speculators dress up like government surveyors and pretend to take measurements in their target district. If they are trying to talk local prices up, they let slip to curious bystanders that a new road is on its way. If they want to bring prices down, they say that the government is planning an incinerator or a slaughterhouse.

The government's response to this chaos shows how torn it is on land policy. Reform-minded officials in Ho Chi Minh city have started public auctions of government land, both to increase supply and to set a benchmark for the informal market. But at the same time, the central government issued a decree threatening dire punishment for officials who turned a blind eye to the illegal conversion of agricultural land to residential use. That, of course, further limits the supply—and fuels more speculation.

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The Philippines

How not to rescue hostages

Jun 13th 2002 | MANILA
From The Economist print edition

America's military advice didn't do the trick

THE Philippine and American governments were quick to reject any suggestion this week that Filipino soldiers had bungled an operation on June 7th to rescue three hostages, including two Americans, held by the Abu Sayyaf group. But it certainly looked that way. Two of the hostages—a Filipino and one of the Americans—were shot dead. The other American was wounded, but rescued. Four of the kidnappers were killed: around two dozen, including their leaders, escaped.

Though the operation was carried out solely by Filipino troops, it was planned by Filipino and American officers. As part of his war on terrorism, George Bush sent more than 1,000 American troops to assist the Philippines' armed forces in their campaign against the Abu Sayyaf, a band of a few dozen armed members of the country's Muslim minority. America says it regards the Abu Sayyaf as international terrorists, although their main activity is kidnapping for ransom in the vicinity of the southern Philippines.

The allies insist that their main objective on this front of the war on terror was not to rescue the hostages, but to destroy the Abu Sayyaf. Now that all hostages are dead or rescued, the field of fire is clear for the Philippine armed forces. American troops are prohibited from doing any fighting, except in self-defence. Instead, they provide training and other support.

American troops are due to leave the southern Philippines by the end of July. Filipino and American officials have spoken of the possibility of extending their stay. Whether the Americans depart or remain, there is always a risk that the Philippine armed forces will again, as often in the past, fail to finish off the Abu Sayyaf. Then, the United States would inevitably be associated with such a failure, in much the same way that it has been associated with the bloody outcome of the operation to rescue the hostages.

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America and Israel

Charmed with smiles and soap

Jun 13th 2002 | JERUSALEM
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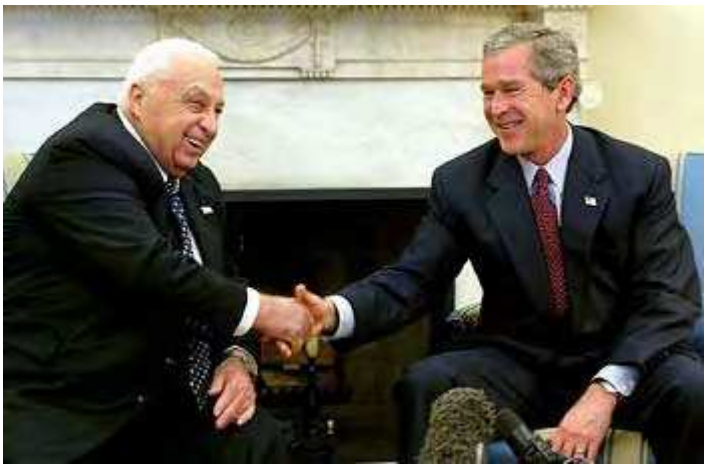

Israel's prime minister is feted in Washington

Get article background

ARIEL SHARON could hardly have wished for more propitious timing. As he sat with George Bush in the Oval Office on June 10th, recounting his battle against Islamist suicide bombers, the American people were being told of the Muslim convert who allegedly plotted to explode a “dirty bomb” on Washington. The news galvanised the hold that Israel's grizzled and unyielding leader seems to have over the Bush administration and much of policy-making opinion in the United States.

“There is no disagreement in this country on support for Israel,” Senator Joseph Biden, the chairman of the Senate Foreign Relations Committee, assured Mr Sharon next day. Political observers stress the American-Jewish clout, and, more recently, the fundamentalist Christian clout, that underpin bipartisan support for Israel. But even the cynics cannot discount the pervasive sympathy, much enhanced since September 11th, for a people perceived to be the victims of a terror akin to that which threatens America itself.

The strength of Mr Sharon's standing in Washington was illustrated by the acquiescence that attended the Israeli army's latest invasion of Ramallah, the Palestinian Authority's much-battered seat of government in the West Bank. Large armoured forces poured into the city before dawn on June 10th. The army slapped a curfew on the town, preventing the new, lean-look Palestinian cabinet from convening for its first session. Dozens of people were arrested; two car-bombs primed for action were allegedly found. Mr Arafat's compound was besieged by tanks but Mr Bush brushed aside questions with a bland reference to Israel's right to defend itself.

“This visit has been a great success,” observed Mr Sharon, as he headed home by way of London, where he urged Tony Blair to see things in the Middle East Mr Bush's way. Above all, he had succeeded in deferring once again that confrontation over the substance of a peace settlement that looms so inevitably, yet so elusively, between Israel and America. He was summoned, at relatively short notice, as part of Mr Bush's consultations with regional leaders before a planned policy speech on the Middle East. Last weekend, the president received Egypt's Hosni Mubarak at Camp David, and at the end of this week he is to see Saudi Arabia's foreign minister.

The speech is expected to rehearse Mr Bush's long-term vision of a Palestinian state, larger and more viable than the fragmented entity that Mr Sharon says he envisages for the Palestinians in the vague and

distant future. Colin Powell, America's secretary of state, spoke this week of the creation of a “provisional” Palestinian state in the interim. In further evidence of the Middle Eastern split between the State Department and the rest of the administration, he received no support from the White House for this idea.

Before the Washington visit, Mr Sharon's aides said he was prepared for a showdown with the Bush team, if necessary, over his refusal to countenance a return to the 1967 borders. In the event, they reported, no showdown, or even argument, took place. They pointed smugly to the president's assertion on June 8th that he is “not ready to lay down a specific calendar” for the creation of a Palestinian state, despite pressure from Mr Mubarak and other Arab leaders.

In his talks in Washington, Mr Sharon dwelt on the Palestinian Authority's record of incompetence, corruption and indifference (at best) to terror. There was much nodded agreement. So long as he can keep the focus on Mr Arafat's performance, rather than on his own hypothetical readiness to make what he calls “painful concessions”, Mr Sharon apparently hopes to be able to stave off any confrontation.

No Palestinian Jefferson, please

Perversely, this logic may have softened Mr Sharon's earlier determination to drive Mr Arafat from Palestine if he could only get a green or even an amber light from Mr Bush to do so. The president, for his part, appeared to move closer to Mr Sharon's previous view that Mr Arafat is eminently expendable. “I happen to believe that there is plenty of talent amongst the Palestinians,” he observed drily, in response to Mr Mubarak's insistence that Mr Arafat was still the man to deal with.

But Mr Sharon, it seemed, was no longer so anxious to see the back of Mr Arafat. While he reportedly warned Mr Bush that he “could not guarantee Mr Arafat inviolability” in every situation, he did not press the point. As Yossi Beilin, a lonely Israeli peacenik put it, what if a Palestinian Jefferson arises to take Mr Arafat's place? What will Mr Sharon do then?

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The Palestinians

Defiance from within the corral

Jun 13th 2002 | EAST JERUSALEM
From The Economist print edition

Crushed and impoverished, the Palestinians still extol armed struggle

Get article background

EPA

Search for one militant, create another

YASSER ARAFAT heard what Ariel Sharon and George Bush were saying from an office surrounded by Israeli tanks. To his people, this summed up his impossible position. He is called on by America to show “leadership”, yet is divested by Israel of all political authority.

Israel's invasion of Ramallah was one of many. This week the army went into four other cities—Tulkarm, Bethlehem, Qalqiliya and Hebron—and fired into refugee camps in Gaza. It can act with ease since the West Bank is now segregated into 220 isolated military enclaves (and Gaza into four) and one in two Palestinians have been reduced to penury. The raids are driven by intelligence extracted from the 7,000 or so Palestinians in Israeli jails, subjected, according to Amnesty International, to “cruel, inhuman and degrading treatment and sometimes torture”.

The incursions and arrests are pre-emptive strikes to thwart Palestinian attacks. They do not always succeed. The past month has seen the militias regroup from the drubbing they received during Israel's military offensive in April, when many of their leaders were killed or arrested, and their stocks of arms were captured. There has been a new surge in guerrilla attacks on settlements in the West Bank, and in suicide bombings inside Israel, the latest being a blast at a restaurant in Herziliya on June 11th that killed an Israeli teenager.

The Palestinian perpetrators are young, nurtured on the hopes of the Oslo peace process but now consumed by an enormous sense of betrayal. Their actions are buttressed by a radicalised national culture that increasingly views all violence against the occupying power as heroic and legitimate. Militant factions are gaining in public esteem, at the expense of the Palestinian Authority and its security forces.

This shift in power precedes the April invasions. Back in December, Mr Arafat persuaded the factions, including Hamas and Islamic Jihad, to agree to a ceasefire. For three weeks, armed attacks in the occupied territories were reduced to a trickle, and suicide bombing inside Israel was stopped altogether. But Israel continued its armed incursions into Palestinian-controlled areas of the West Bank and Gaza. More than 20 Palestinians were killed during this period, including a Palestinian militant who was assassinated in Tulkarm. The relative quiet came to an end when Hamas guerrillas killed four Israeli soldiers, in revenge for the death of three teenagers in Gaza, and Israel responded by destroying 66 refugee houses in Rafah.

From then on, the factions began to see a ceasefire as about as germane to their cause as Mr Bush's “vision” of a Palestinian state. And the suicide bombers started to be dispatched not only by Hamas and Islamic Jihad, but also by Mr Arafat's own Fatah movement and its new, radical offshoot, the al-Aqsa Brigades.

Can Mr Arafat once again tame his vengeful young? He might be able to do so, but on three conditions. Elections that reflect the new power that has emerged on the street, tangible relief from the Israeli sieges and incursions, and a political process that takes steps toward ending Israel's 35-year military occupation. Otherwise, Mr Arafat may soon be rendered as irrelevant to his people as he already is to the Israelis and Americans. His successors may be even less accommodating.

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Western Sahara

Numbered days

Jun 13th 2002
From The Economist print edition

The Saharawis' last-ditch fight for self-determination

WAS Morocco's revelation this week of al-Qaeda's alleged plans to blow up British and American warships in the Strait of Gibraltar a payback for American support on Western Sahara? Ahead of a Security Council vote on April 30th, the Americans had circulated a draft resolution proposing that the UN give its blessing to Morocco's 1975 annexation of the desert territory, while providing the hapless Saharawis with the pickings of self-rule.

In the end the Security Council postponed taking a decision for a further three months. But the Moroccans are quietly confident that the end is nigh for Saharawi hopes of gaining their own state: support for Morocco's position on Western Sahara is one of the few issues on which America and France agree. The Americans helped to push through the 1991 plan that promised the Saharawis a referendum on self-determination. But Morocco thwarted this plan, and now America, too, is siding with the strong against the weak.

What can the Saharawis do? Ironically for a desert dispute, the battle for Western Sahara is now being waged at sea, by way of the multinational firms prospecting for oil off the Atlantic coast. Their arsenals reflect their relative strengths. The Moroccans have heavyweights: the French giant, Total Fina Elf, and the American middle-ranking player, Kerr McGee. The Saharawis have the services of a minor Australian oil company, Fusion.

This is unlikely to lead to gunboat diplomacy. Fusion's brief is simply to examine available data. And even to tempt it on board, the Saharawi independence movement, Polisario, had to concede an option to explore almost a third of territorial waters should Western Sahara ever get statehood. Nevertheless, the counter-claim is a reminder that the former Spanish colony's mineral wealth is not uncontested.

Earlier this year, the UN's legal adviser determined that Morocco would be in violation of international law if it allowed foreign firms to produce oil from the disputed territory without taking into account the interests of its inhabitants. Incidentally, Morocco's relationship with oil has not, so far, been a happy one. When King Mohammed chose his birthday party to announce that Morocco had struck huge lakes of oil, the black gold turned out to be mud.

Morocco's Western Saharan policy could also founder on the question of human rights. The Laayoune branch of the Rabat-based Forum for Truth and Justice is reported to have produced a report accusing the Moroccan authorities of genocide against the Saharawis. But when two of the alleged compilers presented it to the Human Rights Commission in Geneva, the Moroccans threatened to dissolve the forum's office in Western Sahara. The denial of free access to journalists—most recently a Spanish delegation whose arrival had long been scheduled—has done nothing to erase suspicions that Morocco has something to hide.

It is not just the beleaguered Saharawis under Moroccan rule, and the tens of thousands more wasting away in desert refugee camps in Algeria, who are held as hostages pending a solution. It is the whole of the Maghreb. The Arab Maghreb Union has gathered cobwebs since its creation in 1988, partly as a result of the spat over what Algeria's president, Abdelaziz Bouteflika, calls Western Sahara's “decolonisation”. Later this month, the region's five leaders were due to meet for the first time since 1995 to try to open their borders, and revive their economies. The Moroccans are doing all they can to keep Western Sahara

off the agenda. But this week Libya's leader, Muammar Qaddafi, offered to mediate an end to Africa's longest-running dispute. This helpful offer prompted King Mohammed to pull out of the summit.

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Congo-Brazzaville

Ninjas, guitars and dodgy democracy

Jun 13th 2002 | BRAZZAVILLE
From The Economist print edition

War brews in Congo-Brazzaville

AP

Another hard day at school

A BEARDED cult leader with dreadlocks and purple robes sat in front of the run-down school building that doubled as his church, strumming a guitar and singing songs about peace. Pasteur Ntoumi looked harmless, which is why the people of Congo-Brazzaville paid him little heed until April. Sure, he had an army of 1,200 so-called “Ninjas” (after the black-hooded warriors of Japanese tradition), but they seemed too fat and placid to pose much of a threat. But then the shooting started.

From the thickly forested, and populated, Pool region, where Mr Ntoumi's Ninjas have run amok, an estimated 50,000 souls have fled in terror. Perhaps 20,000 have made it to the capital, Brazzaville, where they have found lodgings with cousins or melted into the slums. The rest are thought to be hiding in the bush, praying that neither rebels nor government soldiers find them. They have reason to tremble. Survivors say the violence is largely directed against civilians. Government helicopter-gunships have repeatedly strafed villages, and its troops are reportedly shooting young men on the off-chance that they might be rebels. Homes have been looted, women raped by both sides.

Why are they fighting? Because Congo has oil, so power pays. The country suffered three civil wars after an election in 1992. The losers did not accept defeat, and armed their own ethnic militias. Much of Brazzaville was blasted to half-bricks, and perhaps 800,000 people fled what was left of their homes. With Angolan help, the current president, Denis Sassou-Nguesso, seized control in 1997, and held on by force of arms purchased with oil money. A peace accord was signed in 1999. Mr Sassou-Nguesso's rivals were exiled or bought off with plum posts.

Mr Ntoumi refused to sign the accord, but observed an informal truce. He held talks with a UN body that had already disarmed thousands of militiamen in a deal that gave them cash to help set up small businesses. It is not clear why the truce failed. Both sides blame each other for provoking a gunfight on March 27th at Mr Ntoumi's headquarters in the wooded hills near Vindza. The Ninjas then attacked the railway that links Brazzaville with Congo's only sizeable seaport, Pointe Noire. Since then, fighting has been sporadic. Most of Pool is off-limits to independent observers, but refugees say the Ninjas have disappeared into the bush, from which they occasionally attack the villages now garrisoned by the army.

In the past two weeks, UN aid flights have been allowed to land in Kindamba, a town surrounded by Ninjas. UN staff found that all but 2,000 of the town's pre-war population of 16,000 had fled. The remnants, mainly women, children and the elderly, were squashed into a bakery's back yard with one latrine and little food. They complained that the soldiers “protecting” them had robbed, bullied and raped them instead.

The fighting is sure to affect the legislative elections now under way. Mr Sassou-Nguesso won a presidential election on March 10th with 89% of the vote, after his main opponents either stood down or were barred from entering the country. The legislative elections are proving less one-sided. Several

powerful politicians failed to win seats in the first round, and more fear defeat in the second round, due to be held at the end of the month.

Mr Sassou-Nguesso wants the ballot to make his nasty regime look more respectable. The rumour on Brazzaville's quiet and tree-lined streets is that the fighting in Pool has somehow been orchestrated by bigger men than Mr Ntoumi, who want a place at the trough, and don't mind sparking mayhem to remind the president that they can do worse if denied their cut.

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About sponsorship

The European Union and immigration

Huddled masses, please stay away

Jun 13th 2002 | BRUSSELS
From The Economist print edition

AP

European leaders say they want harmonious EU action against illegal immigration. In reality, nearly all governments are still sticking to policies of their own

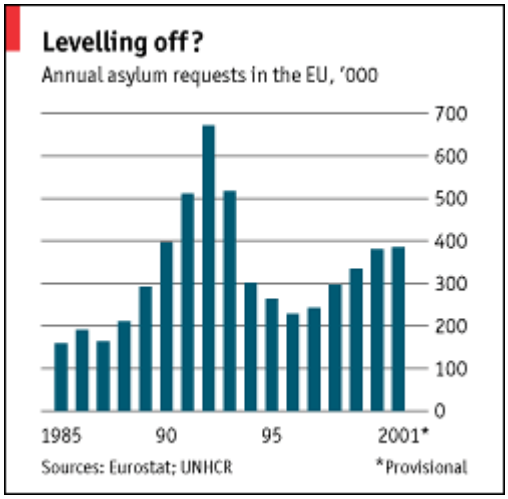
“GIVE me your tired, your poor/ Your huddled masses, yearning to breathe free”, proclaims America's Statue of Liberty. If the European Union were to build a similar monument in Brussels, what message would it carry? Perhaps something like: “We have vacancies for a limited number of computer programmers and will reluctantly accept torture victims with convincing scars. Migrants looking for a better life can clear off.”

As they prepare for a grand summit in Seville on June 21st-22nd, the EU's leaders have made it clear that controlling illegal immigration will be the top item on the agenda. This new-found urgency stems from the recent rise of populist anti-immigration parties across the Union, including France's National Front, the Freedom Party in Austria, the Pim Fortuyn list in the Netherlands, the Northern League in Italy and the Danish People's Party. European leaders are worried that if they are not seen to act against illegal immigration, the far right will gain even more ground.

The EU's best guess (see article) is that the Union's domains absorb 500,000 illegals every year. Although the popular image of these people is formed by television pictures of Iraqis and Afghans trying to hop aboard trains that go through the Chunnel to Britain, or of Albanians struggling to cross the Adriatic to Italy in rickety boats, most illegal immigrants in the EU enter legally and simply stay on when their visas run out. Despite some politicians' steamy rhetoric, nobody really knows whether the flow of illegal immigrants is going up or down. It is known, however, that the number of refugees claiming political asylum in the Union has slowed sharply over the past decade. Last year 384,530 people claimed asylum, against 675,460 in 1992 (see chart).

For several years EU leaders have been promising a common policy for both illegal immigration and asylum seekers. Now that the Union (bar Britain, Ireland and Denmark) has scrapped passport controls for travelling within it, logic suggests that a common approach to controlling the EU's external frontier should be forged. Having 15 different national regimes for asylum and naturalisation has also led to worries that illegal immigrants are “asylum shopping”, and to recriminations between neighbouring countries like Britain and France, and Denmark and Sweden.

But while EU leaders love harmonisation in theory, in practice progress has been very sticky. A senior official at the European Commission, which has been trying to hammer out common policies, laments “a general unwillingness to change national systems whatever they may be.” Britain, for instance, lets asylum seekers look for work six months after they have lodged their application; Germany makes them wait 12 months and France 18. Trying to find a common approach to family reunification has also proved fraught. Germany wants to prevent children older than 12 joining their parents; others see this as too tough. The Dutch want gays to be allowed to join their partners; the Spanish are dead against the idea. In theory, EU leaders also want a common time-frame for assessing asylum claims; in practice, many home ministers say they cannot give deadlines to judges.



It is unlikely that putting illegal immigration at the top of the agenda in Seville will lead to a breakthrough. The summiteers will look for progress in two specific areas. First, they will ponder the idea of an EU border-police to replace national frontier controls. That will be deemed a step too far for now, so instead there will be moves towards exchanging information on visas and an emphasis on greater co-operation between frontier police. Second, the leaders may try to pursue a British idea of trying to link foreign aid to countries' willingness to take back refugees whose asylum applications have been rejected. This may generate the headlines that EU leaders want about “tough action”. But the reality will be messier. A link, maybe, as Italy plans; but no one will subordinate aid to the fight against illegal immigration.

So a genuine harmonisation of asylum policies will have to wait for another day. Commission officials hope that in about six months they may secure agreement on family reunification. Establishing common procedures for processing applications and appeals is likely to take much longer. In any case, some officials reckon that even if a fully harmonised set of EU rules is eventually achieved, it would be unlikely to ensure that all EU countries share a proportionately equal burden of asylum-seekers. That is because the laxness or otherwise of national regimes is only one factor determining where asylum seekers make their claims: family and cultural ties, work opportunities and language are just as important.

Liberals within the commission and elsewhere are hoping that the Seville summit will not strike too punitive a tone. “We might get something into the 13th paragraph of the summit statement, acknowledging that EU countries actually need immigrants,” says one official wryly. But the argument that allowing more legal immigration is both the way to stem illegal immigration and to solve the problem of the EU's ageing population is widely viewed as too simple. As the same official points out, “We know from America's experience that allowing lots of legal immigration does not put a stop to illegal immigration.” EU studies have also suggested that immigration alone will not be enough to make Europe's population younger.

So in calling for the harmonisation of EU policies on illegal immigration, European leaders are engaging in a great deal of double-talk. The number of asylum-seekers does not bear out talk of a worsening crisis. And the actions of political leaders do not suggest a great desire to surrender control of national immigration in favour of a common EU approach.

On the contrary. In the weeks before the Seville summit, several EU governments have taken unilateral measures to tighten up their own immigration regimes. Denmark has brought in a law cutting benefits to asylum seekers and making it harder to bring in spouses or elderly relatives. Italy will soon have one that would make non EU-citizens be fingerprinted if they want to live in the country (see article). Britain's government has proposed educating the children of asylum seekers outside the main school system. In Austria, immigrants will have to try harder to learn German. Other countries may well follow suit. EU governments can talk till they are blue in the face about a common approach. For now, unilateral action is still the order of the day.

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Migration statistics

Cross-frontier chaos

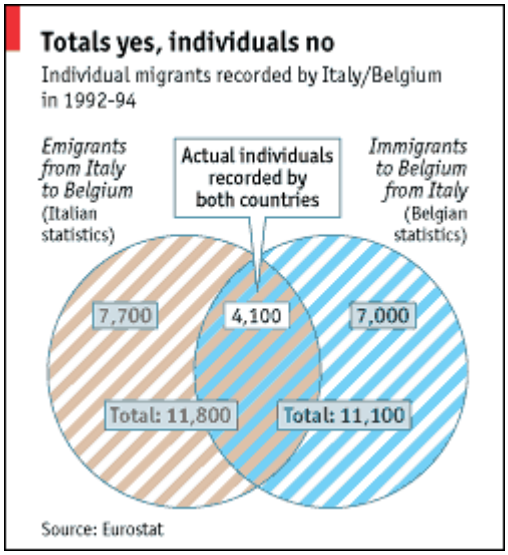
Jun 13th 2002
From The Economist print edition

Defining migrants is simple enough. Counting them is much trickier

WHO is an “immigrant”? The United Nations has a simple definition: a short-term migrant is anyone who moves to a new country and stays from three months to a year; long-term, one who stays a year or more. And there simplicity gives way to statistical chaos.

Why? Surely it is easy to count all legal migrants? No. Cross-check country A's figures of immigration from country B, with B's figures for emigration to A. They should match. In fact, they often differ vastly: in one case in every three, said a study of 1995 figures among European Union countries—and not just because emigrants are harder to pin down than immigrants.

Even if the figures match, that may be chance. One study covered flows between Belgium and Italy. For the flow south, the two countries' data differed hugely. But for the flow up into Belgium the two almost agreed. Euroharmony restored? No. Of the actual individuals concerned (see chart), only 35% figured in both lists.



In sum, migration data are as reliable as a politician's promise—and politics is one reason. Granted, foreigners who just slip in cannot be counted. But asylum-seekers can. Yet few countries list them, in their embarrassing numbers, as immigrants. In Switzerland, some get “temporary” residence permits of a year or more. But even they join the migration figures only when they get permanent residence. In Britain, acceptance or rejection can take years. Often, the asylum-seeker vanishes meanwhile—but still, officially, he isn't there.

But the big problems are administrative. Not all countries use the UN definitions: in Germany, a stay of seven days can be “immigration”. But even if all did, the figures are not reliable. Few countries see flows of their own citizens, however large or for however long, as migration. And most figures even of foreigners are by-products of data gathered, by separate agencies, for other reasons, not to measure the flow or stock of migrants. And always the enumerators face practical difficulties.

Take the simplest task, a count of legal, visa-carrying, foreign incomers. Officials know what the man, and his visa, say. But what will he do? No one can, let alone will, know until he has done it. In time, the census or population register should spot him. But two of Europe's big countries of immigration, Britain and France, have no population registers—and censuses typically are ten years apart. Even then, they may not reveal much. Only in 1999 did the French census ask, “When did you arrive?”

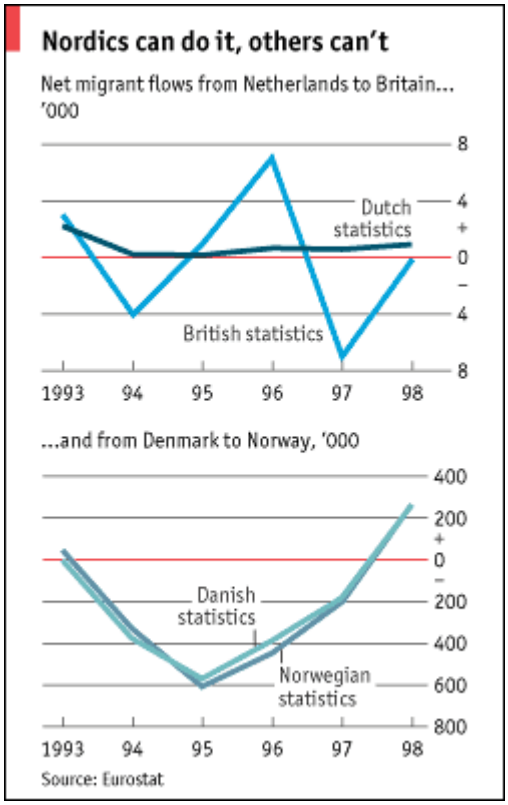
France has a central register of residence permits given to aliens. That sounds enough. Not so. A residence card may be valid for ten years. Has the holder died meanwhile? Or been naturalised? Or left France? Belatedly, two distinct agencies can answer the first two doubts. But little is known about departures, probably (no one can be sure) the biggest factor of all: governments worry about foreigners who are in their country, not those who aren't.

In contrast, the Netherlands since 1994 has run computerised population registers. They are decentralised, but, in theory, the central statistical body is told of every individual birth, marriage, death or migration (for a planned four months coming in or eight

going out). This provides some solid data, though not distinguishing between long-term and short-term migrants.

Most European states have national or municipal registers, if few of Dutch quality. Britain is the other extreme: no population register, no register even of resident foreigners. Our second chart shows one result: the huge differences between Dutch estimates and British ones (based on a sample survey of travellers) of the net flows between the two in the mid-1990s.

Yet it does not have to be so. The Nordic countries not only manage their own data well but keep each other informed. Thus, as the chart shows, their figures of intra-Nordic flows tend to match closely.



And yet, in the real world of rising populism, how useful is that? West European governments (though not East European ones) are shy of asking, even in censuses, about ethnic origins. But prejudice distinguishes by language, religion or skin-colour, not citizenship; and so may real needs, notably in schools. Dutch and Danish statistics make it possible to count up second-generation "immigrants" born in those countries. So, largely, until a recent change, did German citizenship law: born in Germany, the child of Turkish immigrants remained, officially, a Turk. These are rough-and-ready figures: a "Turkish" child may have special religious needs, but none for special lessons in German. But they may be useful, for good purposes as for bad.

Yet such figures are rare. Add in the huge unknowns of illegal immigration, and the exclusion of asylum-seekers from the total, and it may be that official migration statistics, however improved, are anyway not counting the totals that matter.

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Italy and immigration

Stemming the flow

Jun 13th 2002 | ROME
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A new law aims to stop the influx of illegal immigrants

THIRTY years ago, Italians still left their *bel paese* to find work abroad. Now their own country is a destination for work-seekers from poor parts of the world—and many Italians don't like it. A new law to control immigration, already approved by the lower house, is now on its way through parliament.

The law aims to get more illegal immigrants actually shipped out, not just issued with expulsion papers. There are maybe 500,000 in the country. In the first year of Silvio Berlusconi's government, 140,000 were caught but only 82,000—despite a one-third increase—actually deported. Now people-traffickers will be more severely punished and Italy will cut aid to countries that fail to co-operate in stemming the flow at source. The navy will be used to intercept immigrant ships, though “not, of course, to sink them,” says the immigration minister, Alfredo Mantovano. But many of the rusting hulks or rotting rubber dinghies that dump Albanians, Kurds and sundry Asians on Italy's southern coasts look quite capable of sinking unassisted.

Legal immigrants will also be required to have job contracts before leaving their home countries. Many small and medium firms in northern Italy and farms in the south depend on them. Some businessmen are already complaining that the new procedures will bring serious difficulties. The large and growing number of families who depend on Philippine or Sri Lankan home-helps are worried too.

As the draft law stands, even legal immigrants from non-EU countries will have to be fingerprinted, though it is said that ways will in fact be found to spare Americans, Canadians and Australians this indignity.

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The French general election

Round one to Jacques Chirac and the centre-right

Jun 13th 2002
From The Economist print edition

In France's two-round general election, the mainstream right is well ahead

Reuters

Will Chirac let Raffarin step ahead?

AN OVERWHELMING victory for the right; the humbling of the Socialists; and the collapse of the extremists, of both right and left. Take the results of last weekend's first round of voting for France's next National Assembly and President Jacques Chirac is entitled to feel blessed.

A year ago, the headlines all spoke of financial scandals attached to his past. More recently, they contemplated a presidential victory for his Socialist rival, Lionel Jospin. Now they unanimously predict that the outcome of this weekend's second round of the general election, on June 16th, will show a "blue wave" of conservatism sweeping across France, just as in several other parts in Europe. Both houses of parliament—the National Assembly and the Senate—will owe their allegiance to a centre-right president. So probably will most of France's 36,861 local communes (each with a mayor), 100 departments and 26 regions. And likewise the Constitutional Council, France's highest court.

Quite what Mr Chirac will do with this power, unprecedented in the Fifth Republic's 44 years, is unclear. For all the campaign talk of modernising the state, reforming taxes and pensions and cracking down on crime, Mr Chirac's team has been careful between the two rounds to be neither too precise nor too boastful. Indeed, Jean-Pierre Raffarin, whose appointment last month as an interim prime minister may well become permanent, says firmly: "Let's listen hard to the message the French people have sent us."

But what exactly is that message? Part of the answer is surely that the French no longer want a president of one colour to "cohabit" with a parliamentary majority, and thus a government, of another. They have tried it three times, the most recent being the forced marriage over the past five years between Mr Chirac and Mr Jospin. A fourth time is now, it seems, impossible. Extrapolate from the first round's results and between 380 and 420 of the next assembly's 577 seats should be held by members of the pro-Chirac Union for the Presidential Majority (UMP). In contrast, the Socialist Party, which had 248 seats in the last assembly, may be restricted to between 120 and 170. As for the Communist Party, which was once the biggest party on the left and still had 35 seats in the last assembly, pundits reckon it will be lucky to get between eight and 17 seats—less than the 20 that constitute a parliamentary group with consequent access to financial support from the state. For the Greens, who, with the Communists, were part of the last government coalition, things look even bleaker: they will get a maximum, say the forecasters, of three seats.

The rest of the answer is harder to decipher. On April 21st, in the presidential election's first round, a third of the votes went to candidates at the extremes of left and right, including 17% for Jean-Marie Le Pen, of the xenophobic far-right National Front. Not only did that promote him ahead of Mr Jospin for the two-man run off with Mr Chirac on May 5th, but it also encouraged the National Front to imagine it would qualify for up to 300 contests in the second round of the general election.

Instead, the Front last weekend got less than 12% of the vote nationwide and qualified for a mere 37 contests in the second round. Of these, 20 will pit it in a duel with the moderate right; eight will be straight contests with the left; and the rest will be "triangulars", with the Front up against both the right and the left. Translate that into power politics and the damage the Front can do this weekend to the pro-Chirac right is feeble—in contrast to 1997, when it qualified for 132 second-round contests, of which 76 were "triangular" and for the most part split the right-wing vote to the benefit of the left.

So Mr Le Pen's predictions (and those of many pollsters) have proved spectacularly wrong. The puzzle is why, since pollsters on the eve of last weekend's voting had found that a good quarter of France's adults more or less shared Mr Le Pen's hostility to the European Union, globalisation, immigration and so on—and that only 49% completely disagreed.

The most obvious explanation is electoral arithmetic. To qualify for the second round, a candidate must come first or second or secure the ballots of at least 12.5% of registered voters—a hurdle the far right thought it would leap with some ease following Mr Le Pen's presidential scores. But the Le Pen team reckoned without electoral apathy. Last weekend's abstention rate was a smidgen below 36%, higher than in any round in any of the Fifth Republic's previous 11 general elections. The bigger the abstention, the bigger the actual vote needed to match the 12.5% benchmark of registered voters. A second explanation, offered by Mr Le Pen, is that only the Front took seriously a recent law requiring, under pain of financial sanction, equal numbers of men and women candidates; a sexist French electorate allegedly then discriminated against the Front's women.

But a third explanation may in the long run be the most telling. The adage of France's two-round elections, be they for presidents or parliaments, is that the voters “choose in the first round and eliminate in the second”. In other words, they use the first round to send a message to the second-round survivors. On April 21st that message—a fear of crime, unemployment, the remoteness of the EU and the impact of globalisation—showed in the protest vote not just for Mr Le Pen on the far right but for Trotskyite no-hopers on the far left.

It was this message that Mr Chirac seemed to hear so much more clearly than Mr Jospin ever did, hence the appointment as his prime minister of Mr Raffarin—a man who is ostentatiously not one of the over-clever Paris elite—with a mandate not just to tackle crime and vandalism but to be seen to be doing so. Assume comfortable victory this weekend for the UMP, and President Chirac will have five years in which to reassure the voters while still carrying through the reforms France needs.

There is, however, a caveat. In 1995, when he was first elected president, Mr Chirac had a similarly friendly parliament, with similar ideas of modernising the nation. And what happened? Within two years Alain Juppé's reformist government was swept away, a victim of street protests and strikes in favour of the status quo. Mr Raffarin may be a deliberate contrast with the arrogantly brilliant Mr Juppé, but the problems he and Mr Chirac will face could well be the same. The president must be hoping history does not repeat itself.

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The French general election

Round one to Jacques Chirac and the centre-right

Jun 13th 2002
From The Economist print edition

In France's two-round general election, the mainstream right is well ahead

Reuters

Will Chirac let Raffarin step ahead?

AN OVERWHELMING victory for the right; the humbling of the Socialists; and the collapse of the extremists, of both right and left. Take the results of last weekend's first round of voting for France's next National Assembly and President Jacques Chirac is entitled to feel blessed.

A year ago, the headlines all spoke of financial scandals attached to his past. More recently, they contemplated a presidential victory for his Socialist rival, Lionel Jospin. Now they unanimously predict that the outcome of this weekend's second round of the general election, on June 16th, will show a "blue wave" of conservatism sweeping across France, just as in several other parts in Europe. Both houses of parliament—the National Assembly and the Senate—will owe their allegiance to a centre-right president. So probably will most of France's 36,861 local communes (each with a mayor), 100 departments and 26 regions. And likewise the Constitutional Council, France's highest court.

Quite what Mr Chirac will do with this power, unprecedented in the Fifth Republic's 44 years, is unclear. For all the campaign talk of modernising the state, reforming taxes and pensions and cracking down on crime, Mr Chirac's team has been careful between the two rounds to be neither too precise nor too boastful. Indeed, Jean-Pierre Raffarin, whose appointment last month as an interim prime minister may well become permanent, says firmly: "Let's listen hard to the message the French people have sent us."

But what exactly is that message? Part of the answer is surely that the French no longer want a president of one colour to "cohabit" with a parliamentary majority, and thus a government, of another. They have tried it three times, the most recent being the forced marriage over the past five years between Mr Chirac and Mr Jospin. A fourth time is now, it seems, impossible. Extrapolate from the first round's results and between 380 and 420 of the next assembly's 577 seats should be held by members of the pro-Chirac Union for the Presidential Majority (UMP). In contrast, the Socialist Party, which had 248 seats in the last assembly, may be restricted to between 120 and 170. As for the Communist Party, which was once the biggest party on the left and still had 35 seats in the last assembly, pundits reckon it will be lucky to get between eight and 17 seats—less than the 20 that constitute a parliamentary group with consequent access to financial support from the state. For the Greens, who, with the Communists, were part of the last government coalition, things look even bleaker: they will get a maximum, say the forecasters, of three seats.

The rest of the answer is harder to decipher. On April 21st, in the presidential election's first round, a third of the votes went to candidates at the extremes of left and right, including 17% for Jean-Marie Le Pen, of the xenophobic far-right National Front. Not only did that promote him ahead of Mr Jospin for the two-man run off with Mr Chirac on May 5th, but it also encouraged the National Front to imagine it would qualify for up to 300 contests in the second round of the general election.

Instead, the Front last weekend got less than 12% of the vote nationwide and qualified for a mere 37 contests in the second round. Of these, 20 will pit it in a duel with the moderate right; eight will be straight contests with the left; and the rest will be "triangulars", with the Front up against both the right and the left. Translate that into power politics and the damage the Front can do this weekend to the pro-Chirac right is feeble—in contrast to 1997, when it qualified for 132 second-round contests, of which 76 were "triangular" and for the most part split the right-wing vote to the benefit of the left.

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Hungary's new right

Beaten but unabashed

Jun 13th 2002 | BUDAPEST
From The Economist print edition

Voted out of power, the right accuses the left of rigging the election. How?

A NEW slogan has appeared on walls in Budapest since Viktor Orban's conservative party, Fidesz, lost Hungary's general elections on April 21st: *Csaltak* (They cheated). It marks a remarkable change in Hungarian politics: Mr Orban is turning the right into a mass movement.

The graffito reflects one of its basic premises: that the right lost the elections because the Socialists and Free Democrats, then in opposition, rigged them. Just how is unclear: electoral fraud is usually the prerogative of governments. No matter, Mr Orban, unabashed, is backing a referendum initiative aimed at preserving ballot papers so that they can be recounted. Not that he doubts the government's legitimacy, he says carefully; it is simply that, with the margins so narrow, the people should know the truth about the figures.

Having launched his swing to populism as soon as it became clear he had lost the first round of voting, on April 7th, he has kept the momentum going. He promises to hold regular mass rallies of a new, multi-party, right-wing movement, which he is calling *Hajra, Magyarorszag!* (Forward, Hungary!), a deliberate echo of *Forza Italia!* (Go, Italy!), the football cheer that Silvio Berlusconi picked for the name of his political party, which now runs Italy. Mr Orban drew a huge crowd to Buda's castle district on May 7th for a rally where he announced the formation of what he called “civic circles”, a bit like communist cells of old, to enable his supporters to mobilise at short notice.

How different from the Socialist Party and its Free Democrat colleagues, now in office under Peter Medgyessy, a far less colourful figure, since May 27th. Mr Orban's team was full of zealots; his rival's is full of technicians, many of them former communists, with little political savvy. Mr Medgyessy was deputy prime minister in the 1988-89 transitional government and finance minister for part of the 1994-98 Socialist-led one, but he is a banker by profession, not a politician. He is still not a member of the Socialist Party.

His response to Mr Orban's populism has been to set new rules to ensure greater accountability. The Socialists have also started airing allegations of crookery under the previous regime, including the controversial sale of 12 state farms and some fat government publicity contracts won by a company close to Fidesz.

But blame-casting will not clear up public finance. Thanks to a pre- and post-election spending spree by Mr Orban's government, the budget deficit hit four-fifths of the projected figure for all of this year by the end of May. To match Fidesz's propaganda, the Socialists themselves pledged $750m in new spending in their first 100 days. The finance ministry, under Csaba Laszlo, once a civil servant there, says it can find the money. But there may well (and should) be hard choices to be made between Mr Medgyessy's promises and both men's prudent instincts.

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Russia and football

Losing crowd control

Jun 13th 2002 | MOSCOW
From The Economist print edition

Russia's police no longer know how to handle a riot

Reuters

Ivan woz robbed

Get article background

DOES Russia need tougher laws on public order or just better police? The lesson of a riot in Moscow sparked by the national team's loss to Japan in a World Cup football match on June 9th is that these days the authorities are unable to cope with anything difficult or unexpected. In the Soviet era, hooligans were often locked up for several years even for a first offence; few young Russians dared misbehave at a football match or pop concert. How drastically things have changed.

This week thousands of drunken fans, who had been watching the match on an outdoor screen near Red Square, where Lenin's corpse must have been turning in its mausoleum, rampaged through Moscow's centre, injuring 75 people and killing two, chasing and beating outnumbered, ill-prepared policemen, burning cars and smashing shop windows. And all within a bottle's throw of the Kremlin.

Debate rages about the blame. Some, as always, see a conspiracy. Molotov cocktails appeared among the rioters surprisingly quickly. Right-wing extremists in Russia, who featured prominently in the fracas, have rum links with the security services. But it looks more likely that the cause of the rumpus was a lethal mix of alcohol, excitement, frustrated national pride and lax policing.

Strikingly, only a few dozen officers were visible when the trouble started, and their brutal but haphazard response provoked rather than contained the mob. While crowds are becoming more western in behaviour, Russia's criminal-justice system is still rooted in the Soviet past: bureaucratic, top-heavy, authoritarian. The average local police station is full of beefy men smoking and chatting, paperwork is tapped out on typewriters, pay is miserable and bribe-taking routine.

Racism is more in evidence too. The rioters beat up a visiting Japanese musician. Most weeks a racist murder occurs. Embassies have complained publicly this year about violence against people who happen to have a black or brown skin.

The culprits are usually thuggish youths, but the police, who often seem to delight in picking on foreigners for even the most trivial breaches of law such as not carrying a passport, are quite frequently

guilty of lawless violence themselves. Azeris in Moscow say that one compatriot, a street vendor, was beaten to death this month by plain-clothes police after a row over a Russian who urinated on his kiosk.

And the likely punishment for the 113 football rioters so far arrested? Retribution is still ferocious, by western standards. Those deemed ring-leaders could be sentenced to as long as eight years in prison. But fear of the law is not what it was.

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Charlemagne

Germany and its Jews

Jun 13th 2002
From The Economist print edition

More than half a century after the Holocaust, Germans still feel edgy about their forebears' complicity. Will they always?

“HOW much more has to happen,” cried Paul Spiegel, leader of Germany's Jews, “before people begin to wonder whether it was right to set up Jewish communities here again after 1945? Must we pack our bags all over again?” That was a year and a half ago, after a firebomb had been thrown into a synagogue in his home town of Düsseldorf (by two Arab youths angry about Israel's treatment of Palestinians, though that became clear only later). The nation gasped. Chancellor Gerhard Schröder called for an “uprising of the upright”. Hundreds of thousands marched through Berlin in protest against an apparent sharp rise in anti-Semitism and racist violence.

Since then, matters have got worse, says Mr Spiegel. This year more than 20 Jewish cemeteries have been desecrated. A firebomb was hurled into another synagogue, in Berlin. Rabbis have advised their faithful not to wear skull caps in public after two groups of Jews were assaulted in Berlin, in both cases by young Arabs. Mr Spiegel says that anti-Israeli protests are a pretext for “a new wave of anti-Semitism sweeping the country”. Germans, he says, “are no longer shy about insulting you to your face.” Jews can no longer feel safe in Germany, he says.

As head of the Central Council of Jews in Germany, Mr Spiegel tweaks the nation's conscience. Though Jews in Germany make up barely 0.2% of the population, his pronouncements carry enormous authority. Almost nobody dares to gainsay him, even when he goes over the top. When, for example, Jürgen Möllemann, deputy head of Germany's liberal Free Democrats, recently castigated the Israeli government's actions, Mr Spiegel accused him of fostering “a dangerous anti-Semitic tradition which evidently still exists in the land of the murderers.” No prominent figure protested. The irrepressible Mr Möllemann then riposted that the “intolerant, spiteful and arrogant style” of Mr Spiegel's deputy, an abrasive television chat-show host, actually boosted anti-Semitism. That, Mr Spiegel retorted, was “the worst insult delivered [to Jews] in the name of a political party since the Holocaust”. He duly demanded, and got, an apology. Now Mr Spiegel says the liberals will not regain their credibility unless they sack Mr Möllemann as deputy leader.

That row, still rumbling, coincided with a no less ferocious one over Martin Walser, one of Germany's most distinguished authors. In his latest novel he describes the supposed murder of an eminent literary critic, who happens to be Jewish, by a disgruntled author. The critic in many ways resembles Marcel Reich-Ranicki, a Holocaust survivor who for many years hosted a television programme where some of Mr Walser's books have been rubbished. In an open letter to Mr Walser in the influential *Frankfurter Allgemeine Zeitung*, the publisher damned the book as a “document full of hate [and] anti-Semitic clichés” and said his newspaper would not serialise it as planned. Mr Walser says his book is merely a satire about the abuse of power in the literary world. He had already incurred the wrath of many of Germany's Jews four years ago when he complained that too often the Holocaust is used as a “moral cudgel” in discussion.

Both cases show how hard it still is for Germans to engage in public dispute with people who happen to be Jewish—or with Israel. “We're defenceless,” says a top civil servant, who refuses to be named. “We can't tell the truth; we're always afraid. Whenever Spiegel turns up, Schröder can't deny him anything. We cherish our Jewish community. We deeply regret that the old Germany, with its successful and assimilated Jews, will never exist again. With their disappearance, we have lost part of our identity. In our foreign policy we will always be on Israel's side. But many Germans think it's scandalous the way the Central Council uses the past to get more and more money out of the government. They are beginning to get fed up with all the blame and criticism and misrepresentation.”

For long after the war, most Germans clammed up about the Nazi past. It was the next generation, the 1968ers, who now run the country, who then began to confront their parents about it. They now hold “a stranglehold over what is morally acceptable and politically correct in relation to the past,” complains Guido Westerwelle, the liberals' 40-year-old leader. But a new generation is coming along which wants to break out of it. Not for them the sackcloth and ashes of their fathers and repentance for crimes they did not commit. They do not want to forget the past. But they want to speak their minds freely, express pride in their country, and have “normal” relations with Jews and Israel.

No, they won't forget

According to a poll out this week, 86% of Germans are still appalled by Hitler's crimes against the Jews. Since the 1960s, every German child has been taught about the Holocaust—in history lessons, in religious studies and in literature. An unquenchable stream of books, articles, films and debates keeps the subject alive, still casting a shadow over the German psyche. Memorials to Hitler's victims are still being built. Europe's biggest Holocaust memorial will start going up this summer in Berlin.

When Hitler came to power in 1933, some 500,000 Jews lived in Germany. By 1945, only 25,000 remained. Now, with newcomers from the east, there are around 130,000. But pollsters say that only 4% of Germans complain that there are too many; only 1% say they would object to having Jewish neighbours. Research institutes put latent anti-Semitism in Germany at 15-20%, too high for comfort but no higher than elsewhere in Europe.

Despite Mr Spiegel's eloquent worries, no hard evidence suggests that anti-Semitism in the population at large is rising. Few serious people deem Messrs Walser or Möllemann anti-Semitic. Their readiness to break literary and political taboos suggests that Germans may slowly be starting to shed their inability to talk candidly about the present without being inhibited by their past. But the process is still bound to be fraught with angst.

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Correction: the Reichstag building

Jun 13th 2002
From The Economist print edition

In our special report on President Bush's foreign policy and his tour of Europe we referred to a speech he gave to "members of the Reichstag". We meant, of course, members of the Bundestag; the speech was delivered in the Reichstag building.

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Housing

Here we go again

Jun 13th 2002
From The Economist print edition

A house-price correction is on its way, and the government won't like it any more than homeowners will

THE government may think that the biggest threats it faces are a tricky decision about joining the euro and the ability of the health service to absorb a lot of extra money without getting much better. It could be wrong. The real danger may, quite literally, be closer to home.

Five years ago, the Labour government pledged to bring an end to boom and bust. For the economy as a whole, it has undoubtedly delivered greater stability, even though economic growth stagnated in the six months to March of this year. But the housing market is now booming so strongly that a painful correction in this most politically sensitive of markets looks ever more likely.

There were many things that helped destroy the last Conservative government: ideological divisions over Europe; sterling's ERM debacle; sleaze. But what may well have done the most lasting damage were the anger and the broken hopes caused by the housing-market crisis in the early 1990s that overwhelmed the Tories' heartlands in the normally prosperous south-east. Such voters might have feared the further fiscal punishment that Labour threatened to visit them with in 1992 even more than they had come to loathe the Conservatives, but, five years later, Tony Blair was a leader almost purpose-built to capitalise on their sense of betrayal and disillusion. Is history about to repeat itself?

House prices measured by the Nationwide index rose in the year to May by 17.9%, the fastest growth rate since 1989. The boom looks set to continue. New mortgage approvals for house purchase, a good forward indicator, climbed strongly in April. On some measures, such as the ratio of house prices to average earnings, the market is nearly as over-valued as in the late 1980s.

There is nothing new in wild swings in the housing market. In the past 30 years, there have been three episodes of boom and bust. This volatility has clearly been associated with economic instability, both in output and retail-price inflation. When the economy boomed, so, too, did housing. This in turn fed the economic boom, most notably in the late 1980s, as people increased their mortgage borrowing—"mortgage equity withdrawal"—and spent it. When the economy crashed, so, too, did the housing market; and with housing wealth falling, consumer spending was no longer turbo-driven by mortgage borrowing. Such equity withdrawal is now heading sharply upwards again (see chart).

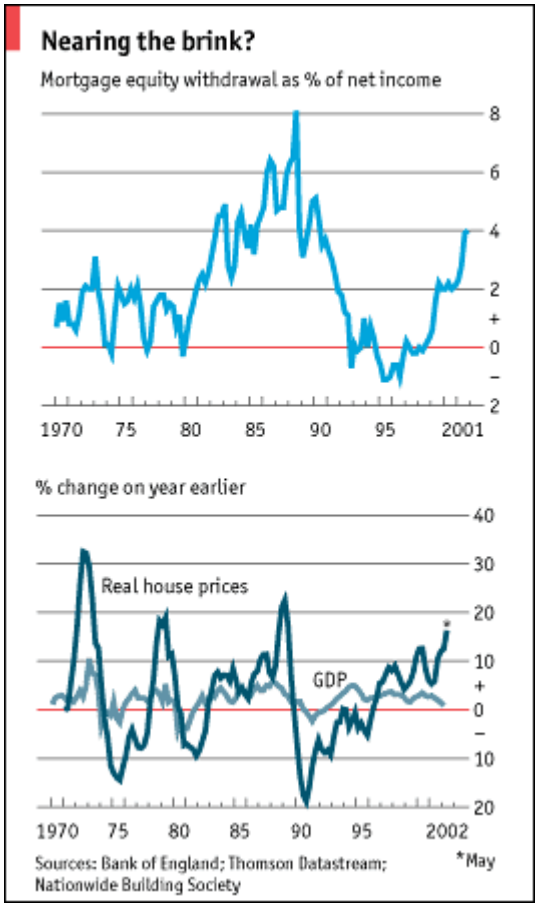
Despite the recent setback to GDP caused by the global slowdown, the economy has been much more stable in the past five years, in terms of both output and inflation. This achievement—which owes much to the government's decision to make the Bank of England operationally independent to set interest rates in order to meet an inflation target—was widely expected to deliver a more restrained housing market. Ironically, that success appears to be contributing to the present house-price boom. For one thing, employment is high and fears of an upsurge in unemployment are low. So prospective homebuyers are confident about their income prospects. More important, inflation is far lower than in the 1970s and 1980s,

and is expected to remain low.

This long-run reduction in inflation has made the initial burden of a new mortgage much more affordable than it used to be. In the past, interest rates were high in order to deal with high inflation. Now that inflation is low, lenders can set much lower rates of interest. So the immediate cost of servicing a standard repayment loan has become much more bearable. According to the Nationwide Building Society, mortgage payments in the first year of a loan are currently around 25% of take-home pay, half the average burden in the 1980s.

But there's a catch. In the past, borrowers had to pay through the nose at the outset but they benefited from the rapid erosion of mortgage debt through high inflation. This meant that their housing equity—the difference between the value of the house and the mortgage debt—increased rapidly. Now the debt will stick around for much longer and today's new mortgage borrowers will no longer benefit from a rapid build-up in housing equity.

With more debt to service, households are more vulnerable than in the past to rising interest rates. Higher interest rates are expected. But, according to George Buckley of Deutsche Bank, the base rate would have to rise from its current 38-year low of 4% to around 7.5% to precipitate a full-scale bust, and he is expecting rates to rise to no more than 5%.



Yet in such a volatile market, a small rise in rates could have a disproportionate effect. And other factors may depress prices. The buy-to-let market, which many have turned to as an alternative to unsatisfactory pension investments, is looking less attractive as surveyors report a decline in rents. And high levels of debt, preventing people from trading up, may drag the market down.

The analysts all expect a correction, most predicting a long, slow one. “It could take the rest of the decade to bring valuations back to normal levels,” warns Saxon Brettell, director of Cambridge Econometrics. That doesn't mean it will be comfortable. “There's pain whichever way it goes for those who are over their heads in debt,” says Mr Brettell. The longer the boom continues, the bigger the subsequent correction that will be needed—and the more likely that an outright bust will occur.

The government is far less guilty of feeding this house-price boom than was its Conservative predecessor. Nor has it made the cause of wider home ownership something of talismanic importance. But it has benefited hugely from the sense of prosperity that buoyant house prices have fostered. Its once impregnable popularity increasingly under pressure on other fronts, a long housing recession is the last thing it needs. Whether it can do anything about it is another matter.

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Northern Ireland

How do you pronounce hate?

Jun 13th 2002 | BELFAST
From The Economist print edition

The Protestants' loss of political power is spawning violence

EARLIER this month, a big change took place in Belfast: Protestants lost political control of the city, which was founded by English and Scottish settlers more than 200 years ago as a bulwark against the Catholic Irish. It was another sign of political power slipping away from Northern Ireland's unionists. The power-sharing administration in Stormont is headed by a unionist first minister but includes the IRA's political wing, Sinn Fein, as well as the moderate nationalist SDLP, their joint vote now repeatedly over 42%. Census findings due next year are expected to show that Northern Ireland's Protestant majority has shrunk to vanishing point.

The election of a Sinn Fein Lord Mayor of Belfast, Alec Maskey, was no more than a belated recognition of reality. Sinn Fein, the IRA's political wing, has been the largest party in the council for several years, but the small cross-community Alliance Party, which holds the balance in the council, had withheld its support until the IRA began decommissioning its weapons. Now that the IRA is getting rid of its guns, the Alliance has handed over its votes.

In the week of Mr Maskey's accession, he went to Short Strand, the tiny Catholic inner-city district at the tip of solidly Protestant east Belfast that is caught up in a spate of stoning and petrol bombing across the “peace line”, one of many walls in the city designed to keep warring communities apart. He said he went to counsel peace. Unionist politicians called the visit provocation.

Thus the atmosphere that greeted Richard Haass, the Bush administration's pointman on Northern Ireland, when he turned up for talks on June 11th and 12th, was far from peaceful. He was mostly there to try to persuade Sinn Fein to sign up fully for the reformed police service by appointing representatives to its supervisory board. But the city was preoccupied by an upsurge in violence. Arsonists damaged two Catholic churches and four schools in Belfast and satellite towns. On the night of June 11th a group blocked a south Belfast bridge flying an Israeli flag—in answer to the republican habit of flying PLO flags in support of Palestinians—while a nearby Catholic primary school was petrol-bombed. Hooded men broke windows at the home of a cross-community Alliance Party representative who had spoken out against loyalist paramilitary murals.

Much of the violence in the past couple of weeks has focused on two streets, marooned in different ways. Protestant Cluan Place is a small outpost of huge east Belfast; Catholic Clandeboye Gardens, which Cluan Place tucks into, protrudes from Short Strand into the Protestant heartland. The people on either side of an inadequate wall are mainly middle-aged to elderly couples. Gangs of young men hurling missiles and occasionally shooting from rooftops in both directions pour into the streets as night falls. Petrol bombs, stones and beer cans have smashed the windows and roof tiles of at least 40 houses. As elderly people in Cluan Place come back to check their homes by day then spend the night with relatives, army engineers have been working to add another eight feet of corrugated iron to the “peace line”, bringing it up to about 20 feet.

The Protestants' fear of Catholic expansionism is evident in the explanations given for the hostilities. Unionist politicians say that Short Strand residents want to expand their enclave. The nationalists' aim, it is said, is to buy homes in neighbouring streets and so move the sectarian divide south to Templemore Avenue, a broad thoroughfare which is a traditional gathering and dispersal point for all Orange marches in east Belfast. If that happened, say the unionists, nationalists would then start raising objections to marches through the area.

The view that the Catholics must be pushed back seems to have made headway. Perhaps the most sinister incident during recent clashes was a confrontation at a college in Tower Street, between Short

Strand and Templemore Avenue. A group of masked men demanded that students produce identification or repeat the alphabet. Many Catholics pronounce the letter “h” differently to Protestants, with an aspiration influenced by the Irish language. Students were evacuated before it became clear what was planned for people with the wrong accent.

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Art

Cut-price class

Jun 13th 2002
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British pictures are too snobbish for American collectors

LOOKING for something cheap to stick on the walls? Go down to Sotheby's, Christie's and Bonhams in London, where auctions of pictures by Britain's greatest painters—Sir Anthony van Dyck, Sir Joshua Reynolds, Thomas Gainsborough, George Romney, Allan Ramsay and Sir Thomas Lawrence—are being held this week. Their paintings were the most expensive school of art ever when the great American collectors such as Pierpont Morgan, Henry Clay Frick, Henry Huntington and Andrew Mellon sent their value to the skies. But Americans don't like them any more, and their value has collapsed.

When the Duke of Westminster sold Gainsborough's “Blue Boy” in 1921 to Henry Huntington, it went for £148,000—around £7m ($10m) in today's money. When Henry Clay Frick bought Gainsborough's “The Honourable Frances Duncombe” in 1914, it cost him £82,700, or £9m.

This week, “Colonel John Bullock”, a full-length Gainsborough painted in the early 1770s, goes on sale at Sotheby's. He aspires to no more than £2m-3m. At Sotheby's, there are two of the grandest “Grand Manner” portraits, Reynolds's “Lord Ferrers” and Lawrence's “Lord Nugent”; the former, painted in 1773 in the red coat of the 15th King's Light Dragoons with country house, oak tree, tall sky and sword, is a spectacular act of towering disdain estimated at £800,000-1.2m; the latter, painted in 1813 in the black coat of a radical writer and politician against heavy clouds and foaming seas, comes for just £200,000-300,000. Before 1929, Reynoldses sold for up to £5m in modern money and Lawrences for £6m.

The trouble, it seems, is the snobbery of British Old Masters, whose main purpose was to make grandees look grander still. Two generations ago, Americans liked that. These days, according to a British dealer, “American collectors look on the British aristocratic portrait as cold, remote, lofty and distant. The US is now a radical democracy and doesn't understand these things.” Or perhaps it understands them all too well and doesn't care for them.

“If you look at the subject alone and are blind to the quality of the painting, there is a problem,” admits another dealer. “Take the average grandee in a landscape painted by Reynolds or Lawrence. There are only four or five expressions on his face. They are: ‘I am a very splendid fellow'; ‘I own this land'; ‘I love my dog'; ‘this is my wife' and ‘down on your knees'.”

Demotic Dutch and Flemish pictures of peasants are the European Old Masters most popular in America these days. Only one kind of British picture has bucked the trend. Kentucky racehorse owners have pushed up the price of British sporting art in the past ten years—so much so that horses painted by Sir Alfred Munnings are now worth far more than their owners painted by Gainsborough.

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World Cup

Three lions, some raspberries

Jun 13th 2002 | EDINBURGH
From The Economist print edition

United Kingdom? Hardly

Get article background

MOST Britons have been behaving strangely in the past couple of weeks. Three times, for around 90 minutes, streets, shops and offices have been deserted for huddles around TV sets. But while most people in most countries are rooting for the same side in the World Cup, that is not so in Britain. Plenty of Scots, for example have been urging the Swedes, the Nigerians, even the Argentinians—anybody, in fact—to beat England. Those countries' strips have become suddenly popular, and sales of Argentinian wine have boomed in Scotland, according to Safeway, a retailer.

Why? The 5m Scots have long felt overshadowed by the 50m English, many of whom annoyingly treat 'England' and 'Britain' as synonyms. It's not unusual for small countries to resent their larger neighbours—the Dutch hero-worship anyone who beats Germany—but the hostility seems sharper and odder amongst those who are supposed to be compatriots.

Some recent opinion polls have claimed to detect that these prejudices have been changing since Scotland gained its own parliament. One poll found a cluster of England supporters in Glasgow. But this turns out to stem from local football rivalries—Celtic (Catholic) fans are also devoted to the Irish cause so Rangers (Protestant) fans back England. At least this is not as bad as Ulster's tribalism: jubilant nationalists in Strabane, County Tyrone, charmingly celebrated Ireland's surprise draw with Germany by stoning a school bus carrying Protestant children.

Some Scots think it is time to grow up. Andrew Wilson, a Scottish Nationalist member of the Scottish Parliament, urged his compatriots to follow him in backing England. He is still alive. His point was subtly nationalist: when Scots get rid of their inferiority complex, he argues, they will also be ready for independence.

Not that the English are immune from football-induced xenophobia. During the dreary draw with Nigeria, England supporters in the stadium, much praised for their failure (so far) to smash up bars and their friendship with Japanese fans, entertained themselves with renditions of the theme tune from “Bridge on the River Kwai”, a classic film portraying the sufferings of the British in Japanese prisoner-of-war camps.

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Pig farming

Skewered

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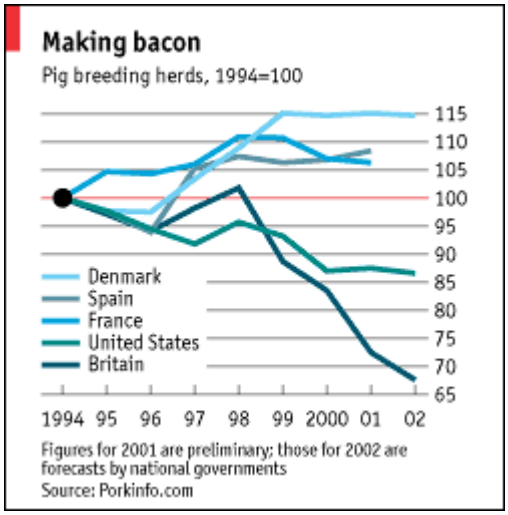
British pigs have nicer lives than any other pigs. That's part of the problem

WHEN Sir Richard Body, a Tory MP, introduced a private member's bill in 1991 to ban the tethering of pigs in narrow stalls, porker welfare became a big issue. Sad-looking pigs in cramped conditions stared winningly up from the pages of newspapers. British hearts melted, the government took up the cause and new rules on pig welfare were passed and came into force in 1999.

Since then, the pig industry has been through the worst time that anybody can remember. Breeding herd numbers in Britain have fallen from 800,000 at the end of 1997 to 550,000 at the end of 2001—far worse than in other countries (see chart). Nobody thinks that the industry has hit bottom yet.

The welfare regulations were only one of a series of shocks to pig farmers. First came BSE. In 1996, after it was discovered that the practice of feeding cattle remains to other cattle was spreading the disease, meat-and-bone-meal fodder was banned. That was less of a problem for cattle farmers than for pig farmers, for cattle can be fed grass and silage, whereas pig farmers had to use expensive soya protein instead. Margins on pigs are slimmer than margins on cattle—£8.75 per pig in 1998, compared with £182 per animal for beef cattle—so there was less to spare. According to John Strak, editor of *Whole Hog*, an online industry newsletter, the extra cost imposed by these regulations ate up 60% of pig margin, compared with 14% of beef margins.



Then came the welfare regulations. When narrow individual stalls in which the animals could not turn round—battery farming of pigs, in effect—were banned, farmers had to build new communal units so that the sows could move around and socialise. Pigs had to have more space per head than before. John Rowbottom, a pig farmer near York, says “I had to spend £150,000 making my units less efficient.”

Since the pigs were presumably happier as a result, it is odd that the next blow was PMWS (Postweaning Multisystemic Wasting Syndrome, if you must know), a stress-related illness. Some put PMWS's appearance down to the closure of some units as a result of swine fever and then foot-and-mouth: units became overcrowded, which may have made pigs susceptible to the disease. It is killing them off in droves. Death rates among litters of just-weaned piglets struck down by PMWS range from 5-30%. And on top of all this came the rise of the pound against the euro, which helped Danish pig-farmers as much as it hurt their British competitors.

The pound is falling. The disease will peak, decline and disappear, as diseases do. The meat-and-bone-meal regulations will come to matter less: as BSE has appeared on the European mainland, so European pig-farmers are facing the same restrictions and therefore the same cost increases. But British pig-farmers will still be at a disadvantage because of the be-nice-to-pigs rules. Similar regulations are not due to be imposed in the EU until 2010. In the meantime, British pork is competing with European battery-farmed pork.

When the regulations first came in, says Mr Rowbottom, “the government said we should advertise our product as premium, and consumers would pay more for it. How's that for the biggest load of rubbish you ever heard.” Most consumers, he maintains, don't care whether or not pork is imported. Even those who prefer to buy British desert indigenous pork when the premium over imported stuff is more than 5%.

Britons like the idea of being nice to animals but do not want to pay for it, so pig farmers are paying instead.

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Railways

Anybody got £15 billion?

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A worse railway, a smaller network or higher fares: those are the options

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THE railways are due to take a step back towards public ownership in the next few days. Network Rail, a not-for-profit company established by the government, is set to announce the terms of its £500m offer to take over the assets of Railtrack, which was put into administration last October. At the same time it has raised a £9 billion government-guaranteed bridging loan to enable it to refinance the network's existing debts and to provide short-term working capital. As most institutional shareholders have indicated that they will accept the government-funded offer, the deal is bound to go through.

Where does this leave the railways? Nationalisation is not an acceptable word in Whitehall because the Treasury is determined that funding for the railways should not be regarded as public borrowing. So far, the arbiter of such matters, the Office of National Statistics, is willing to go along with this fiction. Yet the reality is that in future the operations of the rail network will be directed, funded and largely controlled by ministers. Adrian Montague, deputy chairman of Network Rail, says that the day to day operations of the railways will be independent. In theory, the new company will be owned by more than 100 “stakeholders”, representing industry, consumers and government. But industry experts doubt that the new board will have any more independence than the old nationalised British Railways Board.

The problem of state control by proxy is that ministers will in future be held directly responsible for the ills of the railway. Soaring costs of maintenance following recent crashes (see chart) have already exposed a large funding gap. The Treasury has been told that Network Rail needs an additional £3 billion-5 billion over the next four years simply to keep the network running safely. But this is only a fraction of the amount that is going to have to be found if the government's ten-year transport plan is to be fulfilled. Tim James of the University of Sheffield, author of “Funding the Railways”, describes railway finance as “a black hole.” He estimates that the railways could be as much as £15 billion short. The idea that most of this money can be raised from the private sector is fast disappearing.

It is not just the network that is in trouble. Almost a third of the (still private) train operating companies are losing money and are having to be bailed out by the Strategic Rail Authority. For the first time since privatisation, passenger numbers and fare revenues are declining on commuter train services. Not surprisingly, the train operators are pressing ministers to accept that they should no longer be expected to bear the burden of economic and infrastructure risks in their franchise agreements.

Unless the new transport secretary, Alistair Darling, can persuade the chancellor that the railways are a priority and that they should get more money in the forthcoming public expenditure round, he will have to cut costs or raise revenues. He has three options. First, he could cut back on planned investment, but this would undermine the government's integrated transport plan and place even greater pressure on the roads. Second, he could reduce subsidies to regional railways, which currently absorb two-thirds of government grants, but Beeching-style cuts would be bitterly fought by the regions. Third, he could raise fares, but this would be even less popular and is politically unsaleable when the railways are performing so poorly. As a leading train operator points out: “Unless someone is prepared to increase fares or take an axe to the network, there is no way the level of needed investment can be met.”

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Online education

Lessons from Auntie

Jun 13th 2002
From The Economist print edition

The BBC wants to move into online education. The private sector is not happy

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WHILE talk in the commercial media world these days is all about bankruptcies and job losses, the sweet sound of expansion is still humming at the BBC. This year, it has launched three new digital television channels, a clutch of digital radio stations, a new Internet search engine and a rebranded interactive-TV service. Its latest push is into online education.

The BBC submitted an application to launch a new “digital curriculum service” to the government last month. It wants to supply schools with free online educational materials, based on the curriculum for 5-16-year-olds, in subjects ranging from English and maths to the Welsh language and “Citizenship”. It plans to spend £150m of licence-fee money on developing the service. The idea is that, as schools become increasingly linked to fast Internet connections, they will be able to offer pupils the chance to learn at their own speed by sitting at a computer terminal and having their lessons online. As with all new services it dreams up, the BBC needs government permission to branch out into this.

Naturally, the educational publishers are livid. While the use of online materials by schools is still fairly limited, this is chiefly because Britain has so few broadband Internet connections and so the experience of online learning is still clunky. But this will change. Already, there are some 2,000 commercial titles of software and digital content available for the English national curriculum alone. Once high-speed connections are in place, online learning could become a lucrative market.

Unless, that is, the BBC tramples over it. “It's going to grossly distort the market,” says Dominic Savage, head of the Digital Learning Alliance, which represents both the small software companies and the big publishers, such as Granada Learning, Reed Elsevier and Pearson, which owns half of *The Economist*. Lots of smaller companies, claims Mr Savage, could go under if the BBC gets its way. The Alliance has written to Tessa Jowell, the culture minister, to ask her to throw out the request.

Mindful of this objection, the BBC stresses that it will contract out half its content production. It insists that its service will be “distinctive”, which is its usual excuse for launching a product that the market already provides. And it says that it intends to supply only half the total market, presumably leaving the more obscure subjects to others.

In an attempt to satisfy the commercial publishers, the government now says that it will provide state schools with “electronic learning credits”, worth £50m in the school year 2002-03, which they can use to buy content from the private sector if they wish. The publishers dismiss this as trifling: they claim that it would take more than three times that sum to stimulate any serious competition to the BBC. Moreover, why would a school that could get the BBC lessons free bother to fill out the forms to use their credits to buy commercial products instead?

The bigger question is why the BBC, which is supposed to be a public-service broadcaster, wants to stride off into online education in the first place. It argues that education has been part of its “mission” since the 1920s: online learning is simply a natural extension of this. But, with no sign of market failure, it is hard to suppress the sense that this is less an exercise in public service than in corporate expansionism.

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Bagehot

The BBC's coup

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The incestuous relationship between the BBC and the Labour elite is unhealthy

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WITH the possible exception of the monarchy, is there any institution in Britain more successful, more resilient and better connected than the BBC? Remarks made by the culture secretary, Tessa Jowell, in an interview with the *Financial Times*, prompt this question.

Basking in the afterglow of a successful jubilee, Ms Jowell said how proud she was of the nation's broadcaster for producing two concerts at Buckingham Palace. “It's an example of the BBC at its very best,” she gushed, “what we all remember it excelling at throughout our lives.” Perhaps carried away by the patriotic sentiment of the moment, she went on: “The prospect of the UK without the BBC funded by the licence fee is anywhere between improbable to impossible because the BBC is one of the most loved and trusted UK institutions.”

In other words, although it is nearly three years before negotiations to renew the BBC's charter are due to begin, the government has already made up its mind to retain the status quo. If the next charter runs for 15 years, which is by no means unlikely, on the eve of its 100th anniversary and more than 25 years after the widespread availability of digital television, the BBC will still be paid for by a compulsory levy on every television-owning household—currently £112 ($160) a year. No other body in Britain has its own hypothecated tax revenue.

A charitable interpretation of Ms Jowell's comment points to the collapse of ITV Digital and the communications industry's current malaise. Any alternative form of funding for the BBC—voluntary subscription, say—depends on all British households signing up for a digital television service. That prospect now looks distant. Still, to announce a decision before a public debate has begun is remarkable even by the standards of a government that deliberately closed down discussion about the future funding of the health service. Yet such is the BBC's influence over the Labour elite that nobody should be very surprised.

To understand why, it is necessary to look back ten years, to the beginning of John Birt's reign as director-general. The Tories, instinctively hostile to the BBC and relentless in their privatising zeal, were back in office for a five-year term that would encompass charter renewal. Mr Birt concluded that, to survive, the BBC had to become very good at strategy and political lobbying. To that end, he recruited a massive apparat, called, in the best Orwellian style, “Policy and Planning”. Under the command of the formidable Patricia Hodgson, and with the expensive assistance of consultants from McKinsey, the young turks of Policy and Planning developed ambitious expansionist strategies to justify the preservation of the licence fee, while bending supposedly sceptical ministers to the corporation's thinking. However, when Greg Dyke succeeded Mr Birt two years ago one of his first acts was to disband Policy and Planning. Mr Dyke wanted to signal a change of style from the old regime, but he also had reason to believe that it was no longer needed.

Mr Dyke is personally close to Tony Blair and used to give money to support the party leader's private office when in opposition. Sue Nye, the wife of Gavyn Davies, the BBC's recently-appointed chairman, has run Gordon Brown's private office for years. John (now Lord) Birt, who once employed Peter Mandelson, has a desk in Downing Street from which he thinks “blue sky” thoughts as head of the “forward strategy unit”. Lord Birt's former diary secretary now works in the same role for Mr Blair. Ms Hodgson's old job (albeit greatly reduced in scope) is held by Caroline Thompson, wife of Roger Liddle, another adviser to Mr Blair.

What even Mr Dyke could not have counted on is the growing clout within government of former BBC strategists. Ms Hodgson herself is now in charge of the Independent Television Commission (which regulates the BBC's commercial competitors), where she is assisted by Robin Foster, her former deputy, and McKinsey's Nick Lovegrove, considered by some to be the second most powerful figure at the BBC during the Birt era. Two of Ms Hodgson's brightest protégés, Ed Richards and Sarah Hunter, both advise on broadcasting issues, among other things, from within Mr Blair's “policy directorate”. Mr Richards succeeded James Purnell (now a rising MP) who also once toiled for Ms Hodgson. At the Department of Culture, Media and Sport, Ms Jowell is advised by Bill Bush, formerly head of political research at the BBC, while Tim Suter, yet another ex-BBC man, runs the ministry's broadcasting division.

So much in common

Commercial broadcasters argue that the intertwining of the BBC and Labour is evidence of some sort of conspiracy. The truth is more complicated than that. The two organisations are bound up with each other because they have so much in common. When the Tories were in power, the BBC, like the Labour Party, was fighting for its life. The talented bureaucratic infighters and disciplined strategists who Mr Birt nurtured were just the kind of clever people with a strong public service ethos and knowledge of how government worked that Labour needed when it came to power.

But it's another thing to pretend that the corporation hasn't benefited from this diaspora. The record certainly suggests otherwise. In the last couple of years, the BBC has been granted everything on its wish-list: a generous and long-term licence fee settlement; approval for new digital channels that compete with commercial offerings in an already crowded market; retention of its unique self-governing status; and now, thanks to Ms Jowell, the promise of an inflation-adjusted £2.5 billion a year in near-perpetuity. The suggestion that the BBC's colonisation of Labour hasn't affected communications policy is, frankly, incredible. As everyone knows, you can take the boy out of the BBC, but you can never quite take the BBC out of the boy.

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A dragon out of puff

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AP

With WTO membership under its belt, and a new leadership ready to take over later this year, China would seem well placed to tackle vital reforms. But expect a long wait, says James Miles

IF THE ebb and flow of China's recent history is any guide, the country is due for a period of momentous change. Every decade or so since the communists came to power in 1949 has seen a juddering shift of gear—the famine-inducing Great Leap Forward, the violent factional strife of the Cultural Revolution, the start of economic reforms and the nationwide anti-government demonstrations of 1989. And already two signposts to the next milestone have come into view.

The first was the country's accession to the World Trade Organisation (WTO) last December, after a 15-year quest. In theory this should not only provide the world with unprecedented access to China's markets, it should also bind China's economic reforms with the norms of international business. Optimists say it could eventually make China's secretive, undemocratic and corrupt government more open and accountable. Pessimists fear it could exacerbate unemployment and financial instability and hasten the collapse of the Communist Party.

The second is a quinquennial party congress due late in 2002 (with no date set yet) which will launch a series of leadership changes. These could be the most wide-ranging of the past two decades and open the way to a transfer of power to a younger, perhaps politically more open-minded, generation. It is equally possible, though, that the new leadership might try to shore up its legitimacy by beating the drum of nationalism and thereby push China into confrontation with Taiwan, the United States and Japan. Rarely in recent years have there been such divergent views on where the country is heading.

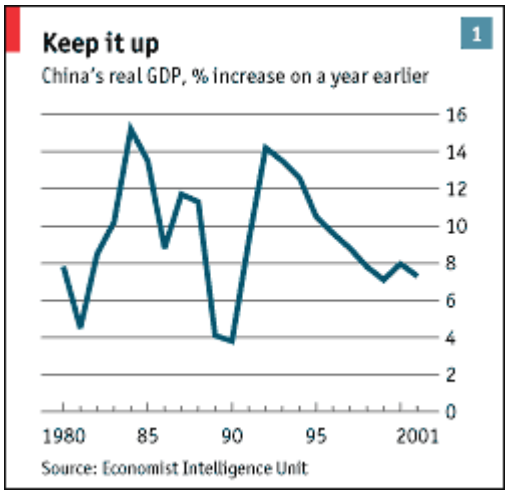
That China has entered a critical phase of its economic reforms is not in doubt. But the hopes (or fears) raised by WTO accession and the prospect of a new generation of leaders are probably misplaced. The way China is run is unlikely to change as a consequence, at least not for several years. What will change China in the nearer term is the handling of the final and most arduous phase of its reform. The chances of failure are likely to rise as Chinese leaders become absorbed in the fractious politics of succession. And the consequence of failure could be the very upheaval that Chinese leaders have struggled so hard to avoid since the convulsion of 1989.

The terms of China's accession to the WTO are more far-reaching than those set for any other new member of the trading organisation or its predecessor, the General Agreement on Tariffs and Trade. They require China to open hitherto jealously guarded markets, such as banking, insurance, telecommunications and agriculture. In some sectors, the lowering of trade barriers will cause unemployment to rise. In others it will create new job opportunities. But tariff barriers are the least of China's problems: its own are already among the lowest of any developing country. Much more important, the country still needs to introduce many changes before it can call itself a market economy. With or without the WTO, China needs to make those changes to keep its half-reformed economy from collapsing. To do this successfully, China must maintain brisk economic growth. Even at the official rate of 7.3% (which was probably an exaggeration), growth last year was insufficient to absorb the fast-swelling ranks of the unemployed. In the coming decade, China needs to create 8m-9m new jobs a year, up from 5.5m-6.5m in the second half of the 1990s, according to conservative World Bank estimates. It could be more. Yet average annual growth is expected to stick at around 7%, about 1.5 percentage points less than the average for the late 1990s.

Where once China was able to able to boost the economy by releasing the pent-up power of sectors restrained by Maoist folly (first agriculture, then small private and mixed-ownership enterprises), it has now run out of easy sources of new growth potential. It must get the marketplace to deploy labour and capital much more efficiently. Both are still being stifled by government interference. China's state-owned banks, which dominate the banking system, are technically insolvent thanks to indiscriminate, politically inspired lending to loss-making state enterprises. Moribund though most of it is, the state sector is still vital to China's economic and social stability because it employs (or at any rate keeps on its books) 45% of the urban workforce and receives most of the state banks' loans.

The various mechanisms that keep a market economy running, from public listings to bankruptcies, are still fettered by politics. In a recent book on China's business environment, “The China Dream”, Joe Studwell put China's bankruptcy rate in the 1990s at no more than 0.05% a year, one-twentieth the level in America. China's two stockmarkets, now a decade old, remain the almost exclusive preserve of inefficient state-owned enterprises. Most of the shares are held by the state or its employees, so ordinary shareholders have no influence over the way the companies are run (usually badly). One of China's richest private businessmen who knows the markets well calls them “congenitally deformed children born after the rape of capitalism by socialism”.

Sustained high growth will require strong demand, yet the incomes of most rural residents (who account for 65% of the population) have been stagnating for the past four years. The only long-term solution will be to move the huge amount of surplus labour in the countryside—at least 150m people—into other sectors. Yet rural credit co-operatives, the obvious source of funding for rural industries, are bankrupt, and cities cannot provide enough jobs even for their own people, let alone an influx of peasants. China will benefit from continuing large inflows of foreign investment and a better export performance as the global economy recovers. But given the country's size, the economy still relies primarily on domestic engines of growth, which are sputtering. Growth over the past five years has relied heavily on massive government spending. As a result, the government's debt is rising fast. Coupled with the banks' bad loans and the state's huge pension liabilities, this is a financial crisis in the making.



Western governments and business leaders once placed great hope in China's prime minister, Zhu Rongji, who took office in 1997 and successfully navigated the country through the financial crisis that erupted in the rest of Asia that year. But Mr Zhu is likely to step down when his current term of office ends in March 2003, with at best mixed results in reforming state enterprises and the banking system. Like the rest of China's leaders in recent times, he has been hamstrung by his unwillingness to do anything that might bring a repeat of the unrest of 1989. Will China's next crop of leaders be any more resolute?

New faces, old ideas

The forthcoming change in the party leadership is the first in communist China's history to be signalled in advance. Until now, changes at the top of the party have followed death or secretive party struggles. Even this time, there has been no public announcement that the current party chief, Jiang Zemin, will step down at the party's 16th congress later this year. Yet there have been many strong hints, some from Mr Jiang himself in meetings with foreign dignitaries, that after the congress he will be succeeded by the vice-president, Hu Jintao. The party's second-highest-ranking official, Li Peng—who played a prominent part in suppressing the 1989 protests—is also widely expected to leave the ruling Politburo, as is Mr Zhu, who ranks as number three. If all this comes to pass, it will be the first time since Mao's death that so many of the top jobs have changed hands at once.

Yet how much difference will these changes make to the way the country is run? Hopeful China-watchers point out that in Taiwan the Communist Party's erstwhile enemy, the Nationalist Party (Kuomintang), eventually embraced democracy after four decades of dictatorial rule during a period of rapid economic growth. But the Nationalist Party was not as weighed down by ideological baggage as the Communist Party. President Jiang's effort last year to open the party to the owners of private businesses (once decried as capitalist exploiters) was an attempt to lighten the load. Yet even that mild concession aroused furious debate within the party. Since then, party officials around the country have been told to exercise great caution when recruiting private businesspeople, and not to give them prominent positions in the party.

One thing the Communist Party does share with the Nationalist Party is a record of pervasive corruption. Economic growth helped the Nationalists survive, despite their poor image, until President Chen Shui-bian of the opposition Democratic Progressive Party defeated them in 2000. But to emulate that trick, China would need sustained double-digit growth to keep unemployment at bay. It has little chance of achieving that, nor would it want to, remembering the inflationary side-effects of its double-digit growth spurt in the early 1990s.

So the party's best bet for avoiding destabilising unrest would be to increase public participation in politics. However, many in the party fear that surrendering any power to the public might lead to a collapse reminiscent of the Soviet Union's. The younger generation of leaders show no signs of being any more courageous in this respect than their predecessors. Mr Hu, at any rate, does not look like the bold, imaginative and determined leader that China needs to steer it through the next few critical years.

In the coming decade, therefore, China seems set to become more unstable. It will face growing unrest as unemployment mounts. And if growth were to slow significantly, public confidence could collapse, triggering a run on banks that would undermine China's financial stability.

As long as the leadership can avoid the kind of vicious internal struggles that prompted the 1989 unrest, the party will probably remain in power. But it will be a weakened, inward-looking organisation, vulnerable to crises. If this forecast proves correct, that is bad news for China and could be bad news for countries dealing with it. A weakly led and politically insecure China, roiled by unfulfilled nationalist aspirations, might prove an unpredictable actor on the world stage.

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Colour me grey

Jun 13th 2002
From The Economist print edition

China's leadership is becoming ever more oligarchic—and ever less charismatic

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AP

Jiang waves goodbye, maybe

CHINA is not a one-man dictatorship; it is a dictatorship of an ever-expanding circle within a self-selecting elite. One man makes the final decisions, but his options are constrained by the competing interests of his colleagues. Chairman Mao ruled as a dictator. Deng Xiaoping made more concessions to his rivals. Deng's successor, Jiang Zemin—lacking the charisma and authority to dictate—has moved even further towards rule by consensus. Mr Jiang's successor, soon to be formally anointed, will have neither revolutionary experience nor conspicuous contributions as an administrator to draw upon. He will be a grey apparatchik whose views as an individual will be less important than those of the collective around him.

Vice-President Hu Jintao, aged 59, is the man most likely to gain the formal trappings of power as Mr Jiang, 75, steps out of the limelight (though not necessarily out of the ruling circle). Mr Jiang has three titles that Mr Hu aspires to take over: general secretary of the Communist Party, state president, and chairman of the Central Military Commission (ie, commander-in-chief of the armed forces). The first title Mr Hu has a good chance of acquiring immediately after the party congress later this year. The second he could add at the annual session of the legislature early next year. Whether Mr Jiang will hand over his third title is less certain, and if not, it will weaken Mr Hu. But as Mr Jiang knows, even having all three titles does not necessarily mean you are in charge.

Mr Jiang acquired the three top titles between 1989 and 1993, yet remained overshadowed by Deng, who exercised power informally well after he gave up his last position in 1990 (he died in 1997). When Deng relaunched China's economic reform efforts in 1992 and sent growth rates rocketing, his only title was that of honorary chairman of the Chinese Bridge Association. History could be about to repeat itself, with a semi-retired Mr Jiang making the key decisions behind the scenes. Only this time the relationship between elder statesman and formal incumbent could be a more uneasy one. Mr Hu is not Mr Jiang's choice for the job.

EPA

Who's Hu?

When he joined the Politburo's standing committee in 1992, Mr Hu was the youngest person to reach that position since the 1960s. But his meteoric rise to the top does not necessarily mark him out as a skilful political fighter. Chinese sources say he was put there at Deng's request to be groomed as Mr Jiang's eventual successor. Mr Hu had distinguished himself not for his imaginative thinking, but for his loyalty. As the party chief of Tibet in the late 1980s, he had firmly suppressed anti-Chinese unrest there.

In Chinese political parlance, Mr Hu is likely to be dubbed the “core” of China's “fourth generation” of leaders, just as Mr Jiang has been the core of the third (Deng representing the second and Mao the first). But as leader-in-waiting for the past decade, Mr Hu has not made his mark on any aspect of Chinese policymaking. Perhaps he was trying to avoid the kind of attention that undid two of Deng's anointed successors, Hu Yaobang and Zhao Ziyang, both of whom were purged for expressing liberal ideas. Or perhaps, as one Chinese academic familiar with Hu Jintao's circle puts it, “he has no thoughts of own.”

Optimists point to Mr Hu's record as president of the party school in Beijing,

where senior cadres are trained for high office. Mr Hu took the post in 1993. Since then, the school has encouraged research into issues beyond the normal ideological staple of Marxism-Leninism-Mao Zedong Thought and Deng Xiaoping Theory, such as the development of social democratic parties in Europe.

No revolutionary

It is encouraging that such ideas are being discussed, but Mr Hu himself (maybe again to avoid undue attention) has stressed that he is not at all in favour of changing the way China is run. “Leading officials must at all times be on their guard against the plots of western hostile forces to ‘split us up' or ‘westernise' us, and against the danger of bringing about our own metamorphosis. There must be absolutely no hesitation or wavering in our commitment to Marxism and the pursuit of socialism with Chinese characteristics,” he told party cadres in January 2000.

Still, the outside world will not have to worry too much about what Mr Hu is really thinking as long as Mr Jiang remains in the political game. He might do what Deng did in 1987 and keep his position as chairman of the Central Military Commission. Another idea he is rumoured to be keen on is creating a new body similar to America's National Security Council and making himself or a close ally chairman of it. Such a body would include representatives from the armed forces, the internal security apparatus, the foreign ministry and the party. China badly needs a better system of co-ordinating competing bureaucratic interests in the event of a foreign-policy crisis. When an American surveillance aircraft collided with a Chinese fighter plane off the Chinese coast last year, each of the seven members of the Politburo's standing committee had to tap into his own information networks before they were able to agree on their response, according to American sources.

It is a sad reflection on China's continuing dependence on personalities rather than institutions, but Mr Jiang may indeed be the best person to take charge of such a body. At least he has demonstrated an ability to keep the lid on hawkish anti-American sentiment within the armed forces and the party. Keeping a formal title would help him to maintain control.

Mr Hu has little experience in international affairs. He visited Western Europe for the first time last October and the United States for the first time only in May. How well he could handle a crisis as China's top leader is anyone's guess. His widely acclaimed photographic memory may make him a quick learner, but Mr Jiang has jealously guarded the foreign-policy portfolio. It is likely that Mr Hu will not only remain answerable to Mr Jiang, but will also be fenced in by Mr Jiang's appointees in the Central Military Commission and in the Politburo.

Reuters

Zeng the rocket scientist

Chief among them is Zeng Qinghong, who is head of the party's organisation department (in charge of party recruitment and cadre appointments). Mr Zeng is a front-runner for promotion to the Politburo's standing committee as well as to a senior post in the Central Military Commission after this year's congress. He will be a powerful rival. For many years he has played a central behind-the-scenes role in foreign policy. When, after the crushing of the Tiananmen protests in 1989, top-level formal dialogue between the United States and China was severed, Mr Zeng was secretly appointed by the party to maintain informal contact with the then President Bush's National Security Council. If China creates its own security council, and if Mr Jiang decides not to lead it himself, Mr Zeng would be a likely head. The close relationship between the two men annoys many in the party, which may explain Mr Jiang's repeated failure so far to get Mr Zeng promoted to full Politburo membership. A condition of Mr Jiang's retirement might be a bigger role for Mr Zeng.

But even though after the congress China will probably still be led by Jiang Zemin (even if not in name), a younger group of leaders will inevitably emerge in the coming decade as Mr Jiang and the two other powerful elders, Li Peng and Zhu Rongji (both 73), gradually fade out. By the time of the 17th party congress in 2007, the transfer of power will be complete. Yet the prospects for this “fourth generation” are not promising. Mr Hu—assuming he becomes the “core”—will face a dearth of educated talent among his generation. Some, like Mr Hu and Mr Zeng, managed to get a good education before the closure of most universities during the Cultural Revolution of 1966-76; Mr Hu is a power engineer and Mr Zeng a rocket scientist. But others further down the hierarchy were less fortunate.

Li Cheng of Hamilton College in upstate New York, who has written extensively on China's “fourth

generation", argues that leaders in this category are likely to have been influenced by their experience of the ideologically inspired violence of the Cultural Revolution, making them more cynical about ideology, more open-minded and less confrontational than their predecessors in dealing with factional politics and social unrest. Yet the next generation of leaders also experienced the collapse of communism in Europe and the 1989 upheaval in China, which may have convinced many of them that any loosening of the party's grip on power could unleash violent upheaval. "Social democracy—without the democracy—is what they are interested in," says Jean-Pierre Cabestan of the French Centre for the Study of Contemporary China in Hong Kong. If so, sadly for China, that would make the fourth generation not very different from the third.

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Seeds of change?

Jun 13th 2002
From The Economist print edition

Deep in the countryside, China is experimenting with local democracy

BUYUN TOWNSHIP is a cluster of villages set among steep hills, bamboo thickets and paddy fields in the heart of Sichuan Province. It is an hour and a half's drive along winding country roads to the nearest city. Many of Buyun's peasants have quit the land in search of jobs elsewhere. Those who remain eke out a living, mainly growing rice and wheat. It is in this dirt-poor backwater that some think they have spotted the seeds of a democratic transformation of China.

As the previous chapter argued, the new leadership that will begin to emerge in Beijing later this year may well be as suspicious of political reform as the current line-up. But democratic reforms such as those conducted in Buyun are starting to be introduced—albeit far from the centre of power—without the party's say-so, or at least with the encouragement only of certain groups within it. Optimists hope that as party control weakens at the grassroots, democratic institutions will begin to take their place and bring about change further up, whether the party likes it or not.

Both in China and abroad, in the past decade there has been much publicity about direct elections in most Chinese villages to the post of village chief. This innovation does not deserve as much fanfare as it has been getting. Village chiefs do have a say in how a village invests any collective funds, but they are not government officials, and are subordinate to village Communist Party secretaries. They are mainly factotums for the lowest tier of rural government, the township, which consists of a group of villages centred on a somewhat larger settlement.

All the same, many in the party are worried enough even about these village elections, let alone the idea of allowing people to elect a real government leader; and indeed in many places the village elections have led to fierce power struggles between the unelected party secretaries and the village chiefs returned in secret ballots. But in Buyun things have gone further. In 1998, without formal permission from the central leadership, the township conducted direct elections to the post of township chief, a person who holds government rank (but remains subordinate to the party secretary at the corresponding level, as is every government leader in China).

Party leaders were anxious, but allowed Buyun to keep its newly elected chief, who happened in any case to be the party's nominee. Normally a township leader is indirectly elected by members of the township people's congress, and there is only one candidate: the party's choice. Members of the people's congress itself are carefully vetted by the party and elected by an unenthusiastic public. The congress acts as the local party's rubber stamp. Fearing that other townships would follow Buyun's example, a year ago the party issued “document number 12” which ordered that the usual indirect method of election be adhered to.

But there were loopholes in the document's wording that Buyun seized upon. Urged on by reformist officials and academics in Beijing as well as in the province itself, Buyun interpreted the party's orders creatively. Seeing that the orders allowed reforms in the way that candidates (but not the final winner) were selected, Buyun conducted competitive direct elections for a single candidate, who was then submitted to the township people's congress for approval. The result was the same as last time, albeit by a narrower margin: victory for the party's favourite, Tan Xiaoqiu.

According to Li Fan, a Beijing-based researcher who monitors rural politics, nearly one-third of Sichuan's 5,065 townships took advantage of the leeway offered by the document. They allowed the public to nominate candidates freely and then submitted the names to a vote by electoral colleges consisting of township officials, people's congress members and village representatives. This method still left plenty of scope for party interference, but it was a small step forward.

Buyun's reformist supporters hope that its elections will eventually transform Chinese politics. The

example they point to is a decision in 1978 by peasants in Xiaogang village in eastern Anhui province to split up their communal land into household plots. It was a hugely risky move at the time, but the reform had powerful backers in Beijing and eventually spread across the country, transforming Chinese agriculture. Five years later the disastrous People's Communes that Mao had foisted on peasants were formally scrapped.

Already in some places, the introduction of direct elections for village chief is causing democracy to percolate into party organs too. New methods of choosing party secretaries are now being tried, with the party's encouragement. “If there are no corresponding changes in the method of choosing [the party secretary], and if the level of democracy and openness is not expanded...[the party's secretary's] prestige and ability to mobilise will be undermined,” said one party journal.

Small beginnings

But can such slow reforms really make a difference in the face of rapid economic and social change? Mr Li, the researcher, says that experiments in rural areas of Sichuan (and to a more limited extent elsewhere) are unlikely to transform China's politics. “The village is not so strong politically. It is isolated. If urban areas start to reform it will be much faster,” he says.

Since 1999, the central government has approved cautious experiments with direct elections in a few urban areas, albeit only at the level of the neighbourhood committee. These committees, like their counterparts in the villages, are not a formal branch of government. Many urban residents hold them in disdain, not least because they are charged with enforcing the unpopular one-child-per-couple rule.

Mr Li admits that in most places where such elections have been tried, residents have shown little enthusiasm. For one thing, many citizens still receive most of their benefits—including health care and education—from their government employers, so have little need for the services of the neighbourhood committees. But Mr Li believes that in the north-eastern city of Shenyang, where unemployment is high, elections have helped to prevent large-scale unrest: “Giving more power to the people is good. Democracy is the way.”

Many of China's current leaders remain unconvinced that democracy helps to defuse social tensions, and given the way it is being introduced they may have a point. A one-party dictatorship cannot co-exist with a parallel democracy without arousing political conflict. This has already happened at the village level, and could happen at the township level too. It is only by good fortune that in Buyun the elected chief gets on well with the party secretary.

And even in Buyun, not everyone is happy with this kind of democracy. “Since this township chief took power, to tell you the truth life for ordinary people is still very miserable. Although he's improved some roads and hooked us up to cable TV, it's still tough for ordinary people,” says a sceptical schoolteacher. “Fees imposed on peasants are still too high,” says another villager. Both asked to remain anonymous. The local authorities do not welcome visits from foreign journalists.

Mr Li predicts that China could have directly elected city mayors within ten years and a directly elected president within 20 years. For public consumption, party leaders themselves do not rule out the possibility that China might one day introduce such reforms. In the 1980s Deng Xiaoping suggested that China might have general elections within 50 years. But to achieve this, it would have to abandon the idea of a one-party dictatorship altogether. Unfortunately the party so abhors any organisation not under its control— whether political, religious or even charitable—that there is nothing to take its place. Dissidents who tried to organise a nationwide opposition party in 1998 were jailed, and no one has tried since, although the Chinese media occasionally air the idea of more thorough political reform.

The leadership is fearful of acting, and will probably remain so until some colossal social or political shock forces it to change. One potential candidate is a collapse of confidence in China's feeble banking system.

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Money worries

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The banking system is in a mess. How can it be sorted out?

THE most likely successor to China's prime minister, Zhu Rongji, is a thin, mild-mannered man who will face an even tougher task than his fiery-tempered predecessor. As the Communist Party's mouthpiece, the *People's Daily*, warned in February, “Often the biggest risk in the course of economic development is that of a financial crisis.” It will require skilful leadership to prevent such a crisis in China in the coming years.

For the past four years, Wen Jiabao, a geologist by training, has had a tough apprenticeship as deputy prime minister with particular responsibility for financial and agricultural affairs. He has fought, with little success, to reduce the state-owned banks' non-performing loans. He has struggled, with equally meagre results, to reinvigorate the depressed rural economy. As an ordinary Politburo member, Mr Wen has had to defer to others, including Mr Zhu, in making policy decisions. But assuming that Mr Wen is promoted to the Politburo's standing committee later this year, and to the post of prime minister early next year (as Mr Zhu hopes he will be), is he likely to tackle these problems any more successfully?

One of the gloomiest predictions comes from an American lawyer, Gordon Chang, who left China in 2001 after living and working in Shanghai for nearly two decades. In his book, “The Coming Collapse of China” (Random House, 2001), Mr Chang argued that China's entry to the WTO would “shake the government to its foundations”. Of the banking system, he wrote: “It is here...that the end of the modern Chinese state might well begin.” Mr Chang said China had about five years in which to sort out its financial mess, including a fast-growing budget deficit, or else face “the laws of gravity”.

Mr Chang is probably overdoing the gloom. WTO entry itself will not precipitate a regime-threatening crisis in China. But the country's financial problems are indeed colossal, and could cause serious economic and social disruption unless tackled effectively.

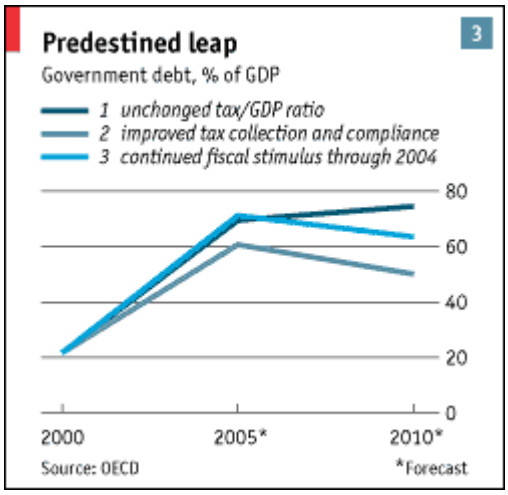
China enjoys some protection because its currency is not fully convertible, making it difficult for ordinary Chinese citizens to move their money elsewhere and impossible for foreigners to move money into or out of China's stockmarkets (except for special shares priced in foreign currency). The country also has a trade surplus, low short-term foreign debt and large inflows of foreign direct investment. In a recent study, the OECD predicted that China's entry to the WTO could cause the country's current-account surplus to turn to deficit by the middle of this decade. But it said this would not pose a serious risk to China's (huge) foreign-exchange reserves.

Vicious circle

All the same, the OECD study argues that a “severe vicious circle” has developed in China. The banks cannot restore their solvency unless enterprise performance improves substantially, but the high level of non-performing loans makes it difficult for banks to provide the funds that enterprises need to restructure and improve their performance. This weakens efforts to improve the banks' credit culture and blunts incentives for enterprises to improve their governance. Poor governance, in turn, blocks the development of capital markets as alternative financial outlets.

The picture is as grim as it was in many South-East Asian countries after the Asian financial crisis in 1997. Officially, non-performing loans (NPLs) in China's state-owned banks amount to 25% of total outstanding loans. But this figure uses an old method of calculating NPLs, and Chinese officials say that if new criteria were used the figure would probably be around 30%. According to Nicholas Lardy of the Brookings Institution, an American think-tank, figures published in 1999 using both the old and the new criteria suggest that the real figure might be more like 50%.

Whether it is 30% or 50%, it points to a dangerously weak banking system—and this is after the transfer of about $170 billion of NPLs (about 18% of total loans) to asset-management companies in 2000. China has been putting pressure on banks to reduce the NPL ratio to 15% (judged by the new criteria) by 2005. This has increased the incentive for officials to distort the figures.



The problem is even more worrying when seen as part of the government's overall debt. Here again the official figure is misleading. The government says its debt-to-GDP ratio is a very manageable 16%. In fact if hidden liabilities, including NPLs, pension commitments and bonds issued to capitalise the asset-management companies are taken into account, the debt-to-GDP ratio is more like 100%. “If you continue the current performance...the system is going to crash in seven to eight years. You are heading towards [a situation like] Russia in 1998 with a default on the domestic bond market,” says Mr Lardy.

It is argued that China's accession to the WTO will help make Chinese industry more competitive to allow it to meet the growing challenge of foreign rivals. But this cannot happen if the banking system does not work. “If transformation (of the banks) is delayed and banks continue to channel disproportionate amounts of funds to inefficient state-owned companies, the leverage of WTO commitments on domestic economic reform will be largely lost,” Mr Lardy wrote in a recent book on China's WTO accession, “Integrating China into the Global Economy”.

On the face of it, China has a strong incentive to move quickly. Two years after WTO entry, foreign banks will be allowed to do business with companies in the Chinese currency, the renminbi. Five years after entry, they will be allowed to do renminbi business with individual Chinese. In the most apocalyptic scenario, these changes could prompt a rush by individual savers and companies to withdraw deposits from state-owned banks and put them into more reliable foreign ones. The result would be a banking crisis. But in practice this is highly unlikely to happen.

Chinese-currency holders will be deterred from transferring their accounts to foreign banks because these will have far fewer branches than Chinese banks. China requires foreign banks to provide operating capital of at least 600m yuan ($73m) for each branch that does business in renminbi. That will be a high price to pay, high enough to discourage foreign banks from attempting to compete for the custom of small depositors.

Too big to fail

All in all, the expansion of foreign banks after WTO entry poses less of a risk to China's banking system than the existing problems of financial weakness, poor credit control and bad governance among borrowers. Maintaining public confidence in the banking system is crucial. More than half the total liquidity is provided by hundreds of millions of individual savers. Last year those individual deposits grew twice as fast as the official GDP figure, despite interest-rate cuts. The public rightly believes that in the event of a crisis the state would bail out the banks.

“The risks of a near-term banking crisis are limited,” says a senior official in an international financial institution. “The question is how long this state guarantee will remain credible. Will it be undermined by the overall level of fiscal debt?” In Beijing, a prominent economist, Fan Gang, is confident there will be no run on banks. As long as the growth of new NPLs is kept under control, their ratio to GDP will fall as output expands. The official forecast for annual GDP growth is over 7% for at least the next five years. “China cannot afford to have a growth rate of 3% or 2%. You have to keep things going. That's the fate of a developing country. If you stop, you're dead,” says Mr Fan.

So can the balance sheets of China's banks be cleaned up? The country's experience so far with asset management companies (AMCs) does not inspire confidence. The AMCs buy the NPLs at face value from the banks and swap them for equity shares in the enterprises concerned. They also sell off the loans for whatever they can get for them—on average around 20% of their face value. But this ratio will plunge in future because the best assets in the AMCs' portfolios have been sold first. The AMCs are having to borrow money to pay interest on the bonds they issued to the banks in return for the NPLs. When the bonds mature, the government will have to bail out the AMCs.

There is little evidence that the AMCs have helped to improve the governance of enterprises in which they have acquired a stake. Nor have they encouraged the banks to become any more responsible in their lending. The banks know that if their NPLs build up again, the government will probably transfer them to the AMCs.

The OECD study calculates that the cost of reducing the NPL ratio to 10% in the big four commercial banks and other financial institutions, and of recapitalising the banks, could be 30-60% of GDP. That is high but not impossible. A rapid and decisive effort, says the OECD, would be less costly than letting the problems persist.

But such a move would require a revolutionary change in the way China's banks and enterprises operate, otherwise the problems will soon reappear. If he becomes prime minister, the consensus-seeking Mr Wen will need to get very tough indeed. And to ensure the growth he needs to carry out reforms, the first thing he will have to do is improve the lot of China's discontented farmers.

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No rural idyll

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China's country dwellers find it hard to scrape a living

WANG HONGBIN, the Communist Party chief of Nanjie village in the northern province of Henan, says he has few worries about China's entry to the WTO. His village is in the heart of the country's central plains, amid an endless expanse of wheat fields dotted with tiny villages. Farmers around here should be nervous about WTO entry: the price of their grain is 15-20% higher than in world markets. As China lowers its barriers to grain and other agricultural imports, wheat prices here are likely to drop. Most Chinese farmers have already endured four years of stagnating incomes. In the next few years, nearly 60% of peasants in Henan expect their incomes to fall or at best remain the same, according to a recent survey conducted by Chinese researchers.

James Miles

Nanjie put Mao on a pedestal

But Mr Wang's village is better prepared than many. Most of the 70m farmers in this province work on plots of land too small to benefit from mechanisation, but Nanjie has transformed itself from an impoverished rural backwater into an impressive-looking spread of factories and apartment blocks. Agriculture has been consigned to the sidelines as Nanjie has used village labour to make instant noodles, beer, packaging materials and a variety of other products.

The village owes its achievements to the collectivisation of its land, which has allowed it to redeploy surplus labour in industry. One of the biggest problems China will have to face in the coming years is finding jobs for at least 150m rural residents for whom there is little to do on the plots of land allocated to them (in Henan, under an acre per household). The OECD estimates that between 1997 and 2010, agricultural employment will fall by around 78m (only 3m more than if China had not joined the WTO). Reallocating this labour and using the land more profitably is essential to maintaining economic growth and social stability in the countryside.

Despite Nanjie's success, its approach is a non-starter for most peasants because land is the only form of social security they have. They have to pay for education and health care, and they get no pensions. They would agree to collectivising only if they could be confident they could earn money and provide for their old age by other means. Few are. Nanjie pulled it off partly because it is next to a county seat, so many villagers could work in the town.

The other reason is Nanjie's leadership. Many Chinese peasants despise the party secretaries assigned to every village, but in Nanjie Mr Wang is the subject of a personality cult rivalling that of Chairman Mao. Indeed, Mr Wang has adopted Maoism as the

village ideology. A decade ago, he erected a 10-metre statue of the late chairman in the centre of the village, guarded round the clock by two militia guards armed with pistols. Schoolchildren in Nanjie learn Chairman Mao's essays by heart, and every household has a Mao statuette on display in the living room.

Chinese leaders recognise that farmers have had a rough time. In 1999, income from planting crops averaged $108 per farmer; in 2000, it dropped to $96, recovering only slightly to $99 last year. Average prices for agricultural produce in China are 20-40% higher than world prices, and supply far outstrips domestic demand, so prices are likely to fall. Boosting rural incomes—whether by moving farmers into industry or into more profitable agricultural production—is vital to ensure sustained economic growth.

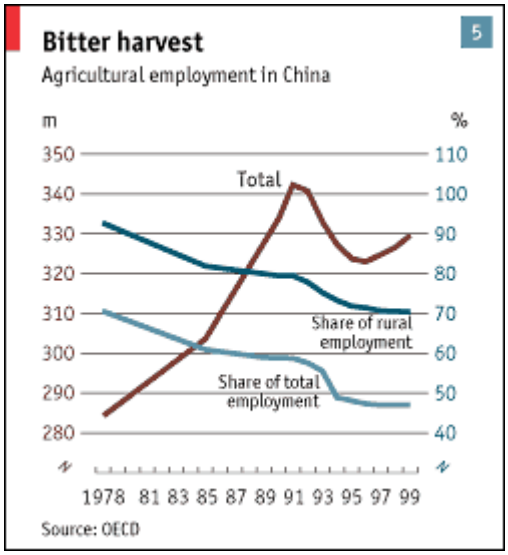
Two decades ago, China decided to break up the Maoist “people's communes” and divide farmland into household plots. At the time it was a splendid idea, at last giving peasants an incentive to work. Both output and incomes soared. But now the countryside is left with a colossal burden: far too many people cultivating far too little land which they can neither sell nor mortgage. With two-thirds of China's population living in the countryside, including towns in rural areas, stagnating rural incomes make it harder for a consumer market to develop. Average rural incomes are only one-third those in urban areas.

Nanjie abandoned the household farming system five years after it was introduced in the village in 1981. Many of Nanjie's peasants had already left their land to work in the town. Mr Wang began by taking over two village factories (which he claimed had violated their contracts) and putting them under collective control. Two years later he called on villagers to surrender their individual land-use claims to the collective. In return they would get jobs in the factories and a monthly handout of flour. Since the land produced so little income, they duly obliged.

A model of its kind

Today Nanjie, with its 3,000 permanent residents and 10,000 contract workers, boasts an output value (unaudited) of around $160m. Visitors to Nanjie have only to look at some of the neighbouring villages, where there is little industry, houses are dilapidated and land is farmed in an inefficient patchwork of household plots, to realise that this is quite an achievement. But even Nanjie is now in trouble.

The problem is one that besets many of China's rural industries. Along the eastern seaboard, these developed rapidly from the mid-1980s to the mid-1990s (far less so in inland areas such as Henan). During this period, township and village enterprises were the biggest contributors to growth in employment and GDP and played a crucial rule in boosting rural incomes. By the end of 1996, they employed 135m people, contributing nearly half of China's exports, compared with one-sixth at the beginning of the decade. But since then they have gone into decline.



Last year, rural enterprises increased their value-added by 8%, but their number fell by 620,000 and employment was down 5m on the 1996 peak. And opportunities for peasants are becoming harder to find: half of those who get new jobs in rural enterprises are workers laid off from urban areas.

Why this decline in what was once the most promising sector of the Chinese economy? One reason is the sharp devaluation of other Asian currencies during the region's financial crisis of 1997, which has made the enterprises' exports less competitive. Another is the credit crunch brought about by China's efforts to reduce non-performing loans in the banking system. In 1997, township and village enterprises accounted for 6.7% of bank loans, already absurdly low given their importance to the economy. By 2001, their share had declined to 5.7%.

A more fundamental problem has been the way these enterprises are run. Many were, in effect, under the control of township and village governments (euphemistically described as “collective ownership”), resulting in poor management and irrational investment decisions. Many of these have now been privatised, but the private sector in China is especially starved of capital.

Nanjie's problems are potentially greater than most. It truly is a collective, with the village providing free housing, schooling, health care and food for all its permanent residents. Yet in the past five years, output value has declined by 19%, and the future looks bleak. Income from tourists keen to study its social and economic model or savour its Maoist revivalism is probably a main lifeline. According to one of Mr Wang's aides, some 300,000 people visit every year.

Noodles, noodles everywhere

Increasingly fierce competition has hit Nanjie hard. Taiwanese noodle manufacturers have rapidly expanded their market share in China, and small-scale beer production has proliferated across Henan. As a diversified conglomerate, Nanjie has been able to cross-subsidise the losses suffered by its beer and noodle factories from more profitable enterprises such as colour printing, condiments and packing materials. And thanks to generous support from higher-level government, Nanjie has been able to increase its borrowing from $60m three years ago to over $97m now. But fierce price competition has sucked Nanjie into a dispute with rival beer producers that has undermined its squeaky-clean, model-village image.

Nanjie's proximity to a town and to a major highway through the province will help it survive. But many small and isolated rural enterprises will be unable to compete as larger-scale private businesses develop in urban areas. WTO entry will help boost some exports that could absorb rural labour, including fruit and vegetables, clothing and textiles. But these new opportunities will be relatively small, and they could disappear again if China's key export markets, such as America and Japan, impose safeguards to protect their own industries from Chinese exports.

Even in the highly unlikely event that China's debt-plagued banks were to extend more credit to rural businesses, this would solve only part of the problem. Despite privatisation, government interference remains a heavy burden. Reforms to the tax system in 1994 gave the central government a bigger share of tax revenue and left many township and village governments close to bankruptcy. Many rural governments now depend on indiscriminate, often illegal, levies on businesses and households to pay the salaries of officials and sustain basic services such as education and health care.

Taxes on enterprises are low in China compared with many other developing countries. But in the countryside, ad-hoc fees often consume 20% of post-tax profits, far more than the taxes themselves. Such fees are also heaped upon individual farmers, who end up paying a higher proportion of their incomes in fees and taxes than do urban residents. Government efforts to stop this practice have met with limited success. The plan is to replace all fees with a uniform tax, but this has encountered strong resistance among rural governments, which are worried about losing even more of their revenue.

The result is growing rural discontent, with ever more frequent outbreaks of unrest. “More and more peasants are submitting petitions concerning the excessive burden [of fees and taxes], and conflicts [between officials and peasants] are becoming increasingly intense,” said an unusually frank report on causes of social instability in China published by the Communist Party last year. Rural unrest worries the government, but not as much as urban unrest because it is easier to suppress without drawing unwanted attention. Although party rhetoric stresses the importance of rural stability, urban centres will continue to attract a bigger share of the central government's resources.

Ultimately, China's surplus rural workers will need to move into urban areas. But the government, fearful of creating its own versions of Mumbai with endless shanty-town sprawls, is hesitant to open the doors to peasant migration. Where restrictions have recently been lifted, it has been mainly in smaller cities. Many peasants work in large cities illegally, but they are denied education for their children, health care and pension benefits. They cannot buy housing, and remain dependant on village land for security in their old age. The system does not prevent the migration needed to ensure a continuing supply of cheap labour, but it is very unfair. No wonder that nearly 80% of peasants in the Henan survey said they were dissatisfied. But would they be any happier in the cities?

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Drastic medicine

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Can capitalism provide a cure?

EPA

Try going private

IN THE coastal province of Jiangsu, one county has been trying out a daring way of coping with the debt that has crippled rural governments and devastated health care and education across much of the Chinese countryside: it has privatised hospitals and schools. Shuyang county is tearing down the last crumbling walls of rural China's socialist edifice.

Fang Wen and Zhou Youming are now the proud owners of the Maowei Township Hospital, one of 38 such facilities that were quietly auctioned off by the county authorities in 2000. The selling spree left only the two biggest hospitals still in government hands. “There was no way out but to reform,” says Mr Zhou. The hospitals could not pay their staff. Many had no X-ray machines, heart monitors or ultrasound equipment. According to a report in the Chinese press, one Shuyang hospital had an operating table with only three legs. A patient rolled off it during an appendectomy.

Mr Fang and Mr Zhou bought their hospital for $51,000, $14,000 more than the reserve price. “Ordinary people had objections to the auctions. They felt there was nothing in it for them,” Mr Zhou admits. There did not seem to be much in it for the new owners either, except a dilapidated facility with no equipment, no beds and 30 staff to pay.

Before the hospital changed hands, residents of Maowei Township preferred to go to neighbouring townships for treatment because their own facility was so poor. Fewer patients meant less revenue for the hospital, which meant less money to spend on equipment, and hence even fewer patients. For a year before it was sold, the hospital could not afford to pay its staff any wages. Employees supported themselves as best they could, using the wards as pigsties and chicken coops.

Mr Zhou and Mr Fang spent another $70,000 buying new equipment, including beds and X-ray and ultrasound machines, helped by earnings from Mr Zhou's sideline business growing flowers and trees. Things are now looking up. The hospital gets 50 patients a day, more than five times as many as before. Salaries have increased by 20-30%. So what does this mean for the hospital's economics? “I am not pursuing profits,” insists Mr Zhou. A visitor to his hospital says the charges are about the same as before. Mr Zhou says they are lower.

Shuyang county may be embracing capitalism, but it still feels uncomfortable with its language. Privatisation is referred to as “changing the system”, “turning into an industry” or, more forthrightly, “cutting off the milk supply”. Across this county of 1.7m people, the experiment has met with mixed success. According to Mr Zhou, eight hospitals have improved since privatisation, ten are about the same and conditions at the other 20 have deteriorated.

The privatisation of schools has also run into difficulties. Here too the county had acted out of desperation: the pay for Shuyang's 11,000 teachers was equivalent to 70% of the county's revenue. In the late 1990s, Shuyang and other counties within Suqian municipality began selling off, merging and closing down schools. But according to residents, Shuyang halted sales in 2000 as parents began to complain about the high fees charged by the private schools.

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Urban discontent

Jun 13th 2002
From The Economist print edition

Reuters

City dwellers demand jobs and benefits

IN A cramped café with half a dozen tables and a bare concrete floor, the manageress laments the slide of the one-time industrial powerhouse of Fushun, in Liaoning province, into economic ruin. “Almost everyone has lost their jobs,” she says. “The young people you see hanging around are all former workers in the factories. People come here in the evening to drink because they are so depressed.” She herself was laid off from the city's state-owned aluminium factory two years ago.

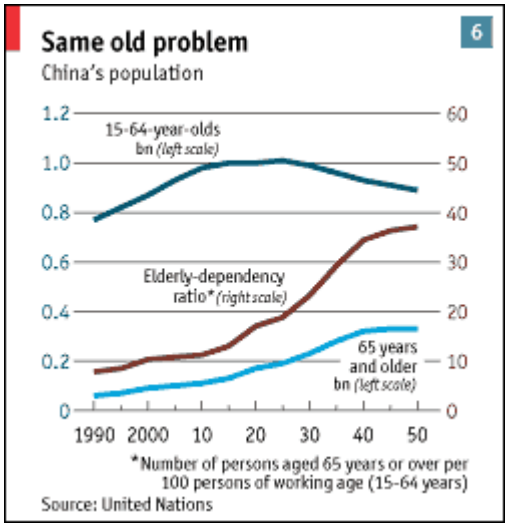
Liquor, at least, is cheap: a 450 ml bottle of Fushun's brand of fiery sorghum spirit costs 35 cents. Her impoverished customers prefer it by the glassful—12 cents buys enough to dull the senses to the grimness of the place. But there is not enough business to bring the manageress or her husband any profit. As laid-off workers, they should be allowed to run their business tax-free. But the government taxes them anyway, and the state-run school that their 10-year-old son attends illegally demands fees. “I'll be begging in the streets in five years,” says the woman. “I'll probably have committed suicide by then,” says an assistant, with not a hint of irony.

Fushun is a city of 1.4m people in the heart of China's rustbelt in the north-east. Its main industries are large and state-owned: coal mining, oil refining, steel and aluminium. The city seems a world away from the dynamic coastal boom towns. People sit with handwritten placards round their necks offering their services as labourers or craftsmen. Every few days a group of workers or pensioners stage a demonstration, bringing traffic to a halt. Their grievances are usually unpaid wages or pensions, or meagre severance pay.

In March, protests erupted simultaneously in Fushun and two other north-eastern cities, Liaoyang and Daqing. Fushun's involved only a few hundred people, but the other two drew tens of thousands and went on for several days. In Liaoyang, smaller protests periodically erupted well into May. It was one of the biggest outbreaks of labour unrest reported in China in well over a decade. The government quelled it in the usual manner, rounding up the ringleaders and promising the others more money. This has been standard procedure since a bout of rioting in the Liaoning town of Yangjiazhangzi two years ago, which prompted a review of the rules to ensure that any unrest was quickly dealt with.

Large-scale urban unrest could draw in discontented people from many different backgrounds and undermine the normal functioning of government and vital parts of the economy. It could also, as happened in 1989, exacerbate divisions in the party. Hu Xingdou, an economist at the Beijing Institute of Technology, argues that, unlike Russia, China has tackled the easier parts of its reform

process first, leaving the problems with the biggest potential for disruption to accumulate. “China has not yet crossed the most difficult hurdles...so I say the real unrest is yet to happen. What happened in 1989 was just a preliminary stage,” says Mr Hu, whose doom-laden essay, “China: the Danger of Turmoil” (the official code for the events of 1989), has been widely posted on Chinese websites.



Trouble ahead

In its annual report on social trends, the Chinese Academy of Social Sciences said that in the coming years China's unemployment rate could surge above 15% (compared with an official figure of 3.6% in urban areas now, though unofficial estimates put it at 8-20%). “If this is not dealt with effectively, it could lead to social turmoil,” the study cautioned. The inflow of foreign investment prompted by China's entry into the WTO would further widen the gap between rich and poor, thus “causing urban residents to become even more unsettled.”

China will almost certainly face growing urban unrest in the years ahead, but not every part of the country will be equally affected. Big cities in the east with fast-growing economies will suffer less than the more backward inland areas and those with concentrations of large state-owned industries. Beijing and Shanghai, the two most important cities, are likely to remain in the former category.

Fushun, on the other hand, is a powder keg. Unemployment there is the worst of any big city in Liaoning province. In the province as a whole, redundant workers (who remain technically employed but receive no salary) at the end of 2000 made up 29% of the total workforce in the state sector. In Fushun, where the state sector accounts for three-quarters of the workforce, the figure was 43%. This amounts to massive hidden unemployment: the city's official unemployment rate was a disingenuous 2.7%. Redundant workers receive an average subsistence payment of just over $100 per year, less than half the national average. They have little to lose by taking to the streets.

The latest bout of unrest in Fushun and other north-eastern cities was sparked by official attempts to pay off redundant workers and leave them to fend for themselves. In Fushun, coal miners complained that their severance packages amounted to a paltry $85 for each year of service. Such protests will almost certainly get worse. Between 1998 and 2000 Fushun formally laid off some 50,000 employees of state-owned enterprises, but six times as many remained to be dealt with.

China is trying to set up a social-security system to take over the welfare role once played by the enterprises. Local governments are supposed to guarantee that no benefits will be lost in the transition to the new system (under which both employers and workers make contributions, some of which go into portable individual pension accounts), but in practice many do not have enough money.

Employees of state-owned enterprises moving into the private sector are particularly anxious, given that many private enterprises have yet to set up pension arrangements of any kind. “For private enterprises, joining the system means adding a new and heavy tax. Naturally they will try to evade the tax by refusing to join, and if...forced to join will report smaller wage bills or fewer workers, or simply go underground,” wrote two Chinese scholars in a paper published last year.

Replacing the iron rice bowl

The anxiety of state-enterprise workers will increase as China tries to grapple with pension liabilities that are growing far faster than contributions. The World Bank estimates that the number of people aged 65 and over in China will rise from 76m in 1995 to 300m by 2050. The ratio of workers to pensioners is expected to decline to 3 to 1 in 2050 from 10 to 1 in 1995, thanks to the urban one-child-per-couple

policy that has caused the birth rate to drop.

Most of the money paid into the individual pension accounts does not go into independently managed investment funds, but is used to meet existing commitments. The government sets the rates of return, which are lower than those on government bonds. This pay-as-you-go system has been in deficit since the late 1990s. A pension crisis is in the making.

At present the government bails out the system with contributions from the central budget. McKinsey, a consultancy firm, estimates that the government must fill a pension gap of $15 billion by 2005 and $110 billion by 2010. The country needs to move rapidly away from pay-as-you-go towards fully funded individual accounts. Yet even if the government could find the money to pay for the unfunded pensions, perhaps through bond issues, setting up a funded system would require it to tackle a range of other equally intractable issues.

Pension funds need efficient capital markets in which to invest. China's stunted bond markets and casino-like stockmarkets will not do. “It's going to take a generation of accounting and auditing and legal specialists to create the transparency [in the Chinese bond market] that we need,” says Gary Benanav, chief executive of New York Life, an insurance company. The company is one of many international insurers eager to tap into China's market, which is opening up far wider to foreigners as a result of WTO entry.

To help fund social-security commitments, China has tried to sell off its shareholdings in listed companies. But it is afraid to sell government shares for fear of angering the millions of ordinary shareholders whose investments might be wiped out by a flood of new stock. Wrathful members of the new middle class could cause more mischief than angry workers in the rustbelt of the north-east.

In the relatively prosperous east the problems are less acute. Job opportunities are far more plentiful and social security is better funded. The city of Beijing has faced only occasional small protests over labour issues—nothing like 1989 when hundreds of thousands of students, factory workers and others converged on Tiananmen Square. But the party fears that as the state retreats from the economy, its own ability to keep control will diminish correspondingly. Hu Jintao has attributed the spread of the Falun Gong sect to the “lack of cohesion and fighting power among some party organisations”, as well as the party's failure to establish a strong presence in “newly established businesses”, for which read the most dynamic area of the economy: the private sector.

In Shenyang, some 32,000 party members left their state-enterprise jobs between 1990 and 1999. About half of them moved into the private sector, but very few have been able to join party cells at their new employers. Indeed, only about 5% of non-state enterprises in the city have such cells. In another decade or two, urban party branches may find themselves largely confined to the government sector. In Shenyang, only 29 new party members were recruited from non-state enterprises in 1999, a sector that employed nearly 640,000 people in the city in that year.

Although the immediate trigger for urban protests is usually some economic grievance, demonstrators often also complain about official corruption, which thrives in China's partially reformed, barely regulated environment. There is increasing public resentment of party officials and factory managers siphoning off state assets, including pension and unemployment-insurance funds, to do their own business, or simply to live it up. Billions of dollars are secreted abroad every year. Indeed, corruption is far worse now than it was in 1989, when it was one of the main causes of the anti-government protests. In Fushun, modern-looking government and party buildings preside over streets of closed factory gates and decaying apartment blocks. In nearby Shenyang, the capital of Liaoning province, a huge scandal erupted last year, linking many of the city's top officials with a local mafia gang. The deputy mayor was executed and the mayor sentenced to life in prison.

Urban stability is also threatened by the fast-growing gap between rich and poor. As one academic put it recently in an official Chinese journal: “No regime can maintain political stability when there is serious economic inequality.” What has exacerbated the problem in China is the unusual speed at which the income gap between rich and poor has grown in urban areas over the past decade. “If we cannot effectively manage social tensions [arising from inequality], then it is possible that economic crisis will beget social crisis and social crisis will beget political crisis,” writes Hu Angang, a well-known economist, in a recent article, citing Indonesia and the collapse of President Suharto's regime in 1998 as an example of what could go wrong. Hu Xingdou, the economist, says that if urban growth rates were to slow down, “the result would be too dreadful to contemplate.”

After reaching a peak of 113m in 1995, the number of people employed by urban state-owned enterprises has fallen by nearly a third. Despite this downsizing, protests such as those in the north-east this year remain the exception, and have not (yet) escalated into a serious political crisis. But as many as half of those remaining at their posts remain surplus to requirements, and may yet lose their jobs. There could be a lot more trouble to come.

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Be prepared

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For all that China is building up its external defences, its biggest battle will be at home

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AP

Something to look forward to

THERE is a curious contradiction between China's vigorous embrace of information technology on the one hand and the myopic nationalism of many of those who use it on the other. If public sentiment had to be judged by the outpourings on the country's numerous Internet bulletin boards, it would appear alarmingly chauvinistic and bellicose. In reality, nationalist sentiment in China is not demonstrably stronger now than it has been for decades. What has changed is the ability of ordinary Chinese to express it. The media are far more responsive to the demands of the marketplace than they were a decade ago, even if they remain far from objective. The Internet has provided an outlet for a small, predominantly urban, well-educated, young and male sector of society to air its views.

Many outside China worry about this overt nationalism, fearing that the country might turn into a Germany or Japan before the second world war: suspicious of the outside world, gaining in economic strength and determined to exercise its growing power. That fear is misplaced. The bigger risk is of a weak and divided China forced by public opinion to deviate from the pragmatic line towards the West and Taiwan that has guided Chinese foreign policy in the past two decades.

The eruption of anti-western protests in 1999 after the bombing of the Chinese embassy in Belgrade showed that even under President Jiang Zemin, who has been especially eager to forge closer ties with the Americans, the government felt that it had to allow public anger to express itself. With a new, inexperienced leadership after the party congress in the autumn, there is a danger of more to come.

Attacking the Americans and Japanese is safe for China's people because the party does so itself (though despite the nationalist noises, the urban elite aspires to the trappings of western consumer culture). The party maintains these attacks because its legitimacy partly rests on its nationalist credentials for having allowed China to stand up for itself after a century of encroachment by colonial powers. Yet in the years ahead, Chinese leaders are likely to be wary of trying to exploit nationalist sentiment because they know it could backfire on them.

In the coming years, America and its friends will have to deal with a China preoccupied with navigating the country through a period of heightened instability. This China will not be eager to exploit volatile nationalist passions that could undermine economic development and exacerbate political divisions. It will be nervous and introspective.

President Clinton, whose rhetoric towards China flip-flopped from hostility to appeasement during his eight years in office, sought a more balanced approach in a speech he delivered in April 1999 in which he urged that: “As we focus on the potential challenge that a strong China could present to the United States in the future, let us not forget the risk of a weak China, beset by internal conflict, social dislocation and criminal activity, becoming a vast zone of instability in Asia.”

A weak China, however, will still be busy acquiring new weaponry and deploying it for potential use in the Taiwan Strait. This year it has placed orders for two more Sovremenny-class destroyers from Russia, having taken delivery of its first two in 2000. American officials believe these ships are intended to deter intervention by American aircraft carriers in any conflict over Taiwan. Other additions to the Chinese armoury (also bought from Russia) in recent years are four Kilo-class diesel submarines and at least 90 SU-27 and SU-30 fighter aircraft. China has also continued its build-up of short-range ballistic missiles

(M-9 and M-11) on the coast facing Taiwan. American officials expect some 600 Chinese missiles to be in place by the middle of the decade.

China is also modernising its strategic nuclear missiles, about 20 of which are capable of reaching the United States. The aim is to make them less vulnerable to a pre-emptive strike by the Americans. China is developing solid-fuelled missiles that can be moved by road, which could be launched much faster. The Russians are helping China to build a nuclear-fuelled ballistic-missile submarine that could be in service by the end of the decade.

These capabilities are worrying to the Americans, but none of them makes China a strategic threat in the same way that the Soviet Union once was. China's nuclear arsenal is dwarfed by America's, even after reductions just agreed between American and Russia that would leave them with between 1,700 and 2,200 warheads each. America's hoped-for missile-defence system would undermine the deterrent value of a strengthened Chinese nuclear arsenal. A senior American official talks about China's “five-minute navy”, which could be destroyed by American missiles. The Kilo-class submarines as well as new diesel submarines built by China itself suffer from operational problems.

The Taiwan card

President Bush's emphasis on the relationship with Taiwan has riled China. Soon after taking office he offered to sell the island diesel submarines, submarine-hunting surveillance aircraft, destroyers and advanced air-to-air missiles. He also promised to “help Taiwan defend itself” in the event of a Chinese assault. The terrorist attacks against America on September 11th (cheered by Chinese nationalists on the Internet) seem to have done little to change underlying mutual suspicions, despite Chinese hopes that they would bind the two countries closer together in a common cause against Islamic extremism. But China's focus on internal stability and its preoccupation with the politics of succession have enabled Sino-American relations to remain on an even keel.

For all the friction between America and China over issues ranging from human rights to weapons proliferation, the likelihood of armed conflict remains slim. Taiwan's independence-leaning leadership will continue to anger China by trying to raise its international profile. But it will stop well short of any constitutional change that would formally sever the notional links between the island and the mainland.

America's defence establishment will continue to hedge against the possibility of Chinese aggression by boosting its military presence in Asia, but its political leadership will try to engage China on as many fronts as possible. Mr Bush, helped by advice from his father, favours this approach, in spite of reservations on the part of some of his close political allies, particularly in the Pentagon. It will be a relationship subject to frequent crises, but most unlikely to fall apart entirely. Economic interdependence between the two countries will increase as China implements its market-opening commitments under WTO rules.

And for all its rhetorical bluster over Taiwan, and despite the arms build-up, China knows that any military strike against the island would need to secure an outright victory (of which there could be no guarantee) or risk inflicting huge political damage on the leadership. The success last year of Beijing's bid to stage the Olympic Games in 2008 is also likely to act as a restraint. China will not want to spoil the coming-out party for its “fourth-generation” leaders.

Chinese nationalism, though contained for now by the country's leadership, will always worry China's neighbours, particularly Japan and Taiwan. Whatever happens, China's secretive military modernisation will encourage defensive efforts by others in the region. “China is changing very rapidly. Its emergence [as a military and economic power] will have an effect on Japanese security policy, India's and maybe ultimately Russia's,” says a Pentagon official.

A hegemon, but not yet

Some Chinese officials, including senior members of the armed forces and the party, openly suggest that they want to see China as the pre-eminent power in Asia, with America and Japan consigned to the sidelines. But there is little evidence of a concerted policy to that end. And even if there were, achieving such a goal would involve either open conflict—which China will do its best to avoid because of worries about its own weakness—or, more likely, a very long wait until the country's economic and military

strength make it the de facto hegemon. By then the Communist Party may look very different—less driven by historical animosities and far more influenced by younger, western-educated people who have returned to China.

As China turns itself into the biggest manufacturing base in the global economic chain, it will need to rely increasingly on imported oil. By 2020, it could be importing as much as 60% of its needs, having been largely self-sufficient until 1993-96. This may bring its perception of global security issues closer to those of America, Japan and other big oil importers, and may make it act more like a country that depends on the West and its markets.

But for all the optimism generated abroad by China's accession to the WTO, foreigners will continue to encounter many obstacles in trying to do business there. The central government may have good intentions, but a myriad local governments will fight tooth and nail to protect their vested interests. And should growth slow down significantly, WTO membership is sure to be blamed. Foreign investors, who so far have encountered surprisingly little nationalistic opposition in China, may then find the going tougher.

The next few years in China will certainly be more turbulent. Economic disparities between regions and between town and country will grow wider, and the urban areas themselves will become more polarised. The booming cities of skyscrapers and glittering shopping malls that so impress foreign visitors to China will, over time, start to look more like cities in other developing countries as country dwellers move in. The shanty towns will spread. And as the market economy develops and the state sector decays, people will feel freer and bolder, while the party will become ever more corrupt.

As long as there is relative unity among the country's top leaders, China will be able to withstand a greater degree of social and economic instability and maintain a generally pragmatic foreign-policy line. The unrest in 1989 got out of hand only because of a leadership struggle that had become highly visible in the months before the protests. The ideological schisms which caused that struggle have largely healed. There is now a broad consensus on the need for a market economy (if not on how exactly to get there). But Chinese leaders are also united in their belief that tolerating organised political opposition might result in their downfall, and should therefore be avoided at all costs. Those who expect the staging of the Olympics in Beijing to encourage greater political tolerance are likely to be disappointed.

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Europe's competition regime

Will the real Mario Monti please stand up?

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A court ruling has given Europe's competition authority a unique chance to reform itself. Will it take it?

IT IS hard not to cringe when reading the judgment handed down by Europe's Court of First Instance on June 6th. Assessing whether the European Commission was right in 1999 to block the merger of Airtours and First Choice, two British travel agents, the court reached a damning conclusion and couched it in unusually strong language. The commission, it said, had been guilty of "manifest error" and had "exceeded the bounds of its discretion". Verdict: the merger was incorrectly blocked, on the basis of incomplete information and unfair decisions.

Many antitrust lawyers could barely conceal their delight at the ruling. It shows, they argue, how flawed Europe's merger regime has become. Despite some good elements, the rules, and the way they are applied, have made life increasingly hard for companies that want to merge. The Airtours decision should now jolt the commission into far-reaching reforms, says Chris Bright of Shearman & Sterling, an American law firm.

The question is whether Mario Monti, the Italian commissioner who heads the competition directorate, sees it that way. His initial reaction was not promising. He noted, fairly enough, that the original Airtours decision was taken a mere five days after he started in the job in 1999. But he then asserted, oddly, that the court had neatly proved that the European Union offers proper judicial review to companies that dispute merger rulings. Airtours may beg to differ. It spent millions on its appeal and, despite winning, has little hope of renewing its offer for First Choice because the market has changed in the three years since the companies announced their £950m ($1.5 billion) merger.

To be fair, Mr Monti is no reactionary. Last December he published a consultative "green paper" on how to improve his agency's record and streamline the merger regime. The move came in the wake of several controversial decisions, notably the commission's blocking of a merger between General Electric and Honeywell, two American companies, and the breaking apart of a merger between Schneider and Legrand, two French ones. Both decisions are under appeal.

The GE/Honeywell decision was particularly fraught, because the deal had already been cleared by America's antitrust authorities. Mr Monti created a political stir amid rumblings that the Europeans and Americans were growing further apart on merger policy.

The spat has since died down, thanks in part to the emollience of Charles James, head of the antitrust division of America's Department of Justice. He visited Europe last month to talk to his counterparts and to demonstrate that close transatlantic co-operation will remain the norm. The rapprochement will be helped by the Airtours decision, say American lawyers working in Brussels. "It is an important positive step towards convergence between the two systems," says James Rill, a partner with Howrey Simon and a former top antitrust official. Yet most observers think the true importance of the Airtours ruling will lie in its implications for the internal workings of the commission.

What about due process?

Praised for its common sense on many technical issues, Mr Monti's green paper has also been criticised

for its narrow frame of reference. It argued, for instance, that the internal processes of the commission's merger task-force—ie, how it actually conducts merger reviews—were beyond the scope of the reforms.

The commission has received some 120 written responses to its green paper, many of which ignore that stipulation. Britain's official comment, pointedly, states that “due process” is the most important subject for debate. That, combined with the Airtours decision, might push Mr Monti into a rethink. Indeed, a prod from the European Court may be just what a reform-minded chief needs to get him to shake up his department.

The question, says Alec Burnside, a partner with Linklaters & Alliance, another law firm, is how to build proper checks and balances into the current institutional framework. The commission often appears to make up its mind early in a case and then, instead of acting objectively, to use the remaining time to find evidence that supports its view. Often, this evidence is furnished by competitors. There is nothing inherently wrong with that, but lawyers say that officials often withhold such evidence until there is no time left for the other side to lodge an effective response.

Take the example of one current merger. The commission is investigating a proposed hostile takeover by Carnival of P&O Princess, a rival cruise operator that wants to merge with Royal Caribbean. At issue is whether a reduction in the number of competitors would harm consumers. Lawyers working on the case say that the commission's documents contain entire chunks of prose lifted directly from submissions made by Royal Caribbean. But the lawyers cannot dispute this effectively because the commission has yet to release all its files.

A further problem relates to the commission's differing treatment of rival parties. Companies that want to merge, and the lawyers who represent them, face harsh punishment if they knowingly submit false information to the commission. But competitors trying to frustrate deals face no sanction. In one case an affidavit from a competitor that was shown to be false was simply withdrawn by the commission and replaced by another. No punishment ensued.

These are not petty matters. The judges who wrote the Airtours ruling made it clear that they had scrutinised closely not only the arguments made by the commission to justify blocking the deal, but also how the officials ran the case. The ruling strongly rebuked the commission's methods, in particular its selective use of documents and its distorted view of the tourism market.

How the commission defines other markets will be crucial in determining the fate of future mergers. Outsiders think that its merger team needs a dedicated economics branch to conduct objective research into markets in which deals are likely to be contentious, something it lacks at present. But the Airtours ruling also puts a new onus on companies to present much richer information to the commission at the outset of a proposed deal.

There are plenty of suggestions for how Mr Monti should change his directorate's work. His own reputation remains high, but it will be under threat if he fails to make reforms. Lawyers observe that he often appears personally remote from specific cases. If he wants to check the shoddy practices that led to the Airtours ruling, he will have to get his hands dirty, perhaps by directly challenging colleagues and officials, some of whom do not take kindly to criticism. Before the Airtours ruling, that prospect seemed far off. Now Mr Monti can show what he is really made of.

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Fiat

Ciao, Paolo

Jun 13th 2002
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Paolo Cantarella's departure is a sign of how deep Fiat's crisis is

AP

Was Cantarella driven out?

WHEN the travails of Fiat were splashed across the front pages for weeks on end in the mid-1980s, the then chairman, Giovanni Agnelli, regally dismissed speculation as “la telenovella dell'estate” (the summer soap). The patriarch of the family that owns about 30% of Fiat's shares cannot afford to be so dismissive today. If the media's feeding frenzy this summer is a soap, the leading actor has written himself out of the script in suitably dramatic fashion.

Bosses do not usually resign at seven o'clock in the evening after an emergency board meeting—unless, that is, they have been arm-twisted into it. Paolo Cantarella, chief executive of the Fiat group since 1996 and previously head of its car division for six years, is going because Fiat Auto is bleeding cash faster than the group can replace it via capital-raising exercises and disposals. Fiat's limp shares perked up on news of his departure.

And yet, despite appearances, senior Fiat sources insist that Mr Cantarella was neither fired nor asked to resign. About ten days ago, they say, he told Mr Agnelli (now Fiat's honorary chairman) that he was going to leave because he had become the symbol of the group's misfortunes; it was time for a change to show that Fiat was determined to cure its problems and avoid a much-rumoured sale to America's General Motors (GM). This came just a few days after Mr Agnelli had publicly endorsed his chief executive.

When the 81-year-old patriarch returned a few days later from New York, where he had been receiving treatment for a prostate condition, Mr Cantarella insisted he would not change his mind. At a hastily called board meeting on June 10th, it was decided that Paolo Fresco, Fiat's chairman and a former number two to Jack Welch at General Electric, would take over as chief executive.

The depth of the crisis at Fiat became obvious when its first-quarter results showed Fiat Auto's loss increasing to *euro*429m ($376m), and its net debt rising by *euro*600m to *euro*6.6 billion—three months into a year when it is supposed to be halved. Fiat Auto is expected to burn through *euro*1 billion of cash this year. Capital spending has been hacked to the limit, just over 3.5% of sales, and 7% of the workforce is being laid off. Despite Fiat's notorious overcapacity, however, only one car plant is being closed, although several assembly lines are being shut down at the company's Mirafiori plant in Turin.

Fiat's problems have been building up for years. Its good reputation as a maker of slick small cars has been a mixed blessing, as it has been difficult to stretch the brand to bigger models. Over the past 20 years a string of small cars, such as the Uno and the Punto, have emerged to revive the group's flagging market share. But Fiat's efforts to develop a successful wider range have failed. For instance, its new mid-sized model, the Stilo, will fall about 20% short of sales targets this year. Consumers found it chock-full of fancy electronics they did not want, and thus overpriced; a cheaper, basic version is now being rushed out.

As long as Fiat dominated the Italian market, thanks in part to a batch of now-dismantled protectionist measures designed to exclude Japanese cars, its inherent weaknesses were overlooked. Another distraction was the pile of cash Fiat earned in emerging markets, such as Latin America, Poland and Turkey. Fiat invested heavily to expand in these markets, just before they all crashed. Suddenly, the

$500m a year of cashflow from the likes of Brazil and Argentina was no longer there. This change exposed Fiat's fading position in Europe. Not only were its model range and brand weak, but its distribution networks were no match for those of its rivals.

Two years ago Fiat, inspired by Mr Fresco's American connections, sold 20% of Fiat Auto to GM; the Italians took 6% of the American car maker in return. Included in the deal was a put option, valid between January 2004 and July 2009. If it chooses to exercise this, Fiat can sell the remaining 80% of Fiat Auto to GM at a price agreed by three investment banks. Should the car makers fail three times over to agree on a price, Fiat would be free to sell the shares elsewhere.

With only 18 months left before the option can be exercised, GM is working on plans to integrate Fiat with its European subsidiary, Opel, in case it has to. Together with Daewoo Motor, a South Korean car maker that GM bought in a fire sale earlier this year, the integration of Fiat would give GM over 20% of the European car market.

If the word from Turin is to be believed, none of this is going to happen. Fiat is trying to offload assets to cut its debt and boost its cashflow, in a bid to remain in the car business—and independent. Like a desperate balloonist throwing out ballast whenever the earth rushes up, it is offering shares in its Ferrari subsidiary, and is also trying to sell its component and steel businesses. Mr Fresco's old employer, General Electric, is rumoured to be interested in picking up bits of Fiat on the cheap.

But the rate at which Fiat is burning cash means that these asset sales alone cannot keep it aloft. Unless it can start selling cars at a profit by the end of the year, it will have to be sold, if only to appease the big Italian banks that are anxious about their exposure. The chances are the put option will have to be exercised. No wonder GM is already doing its due diligence.

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Semiconductors

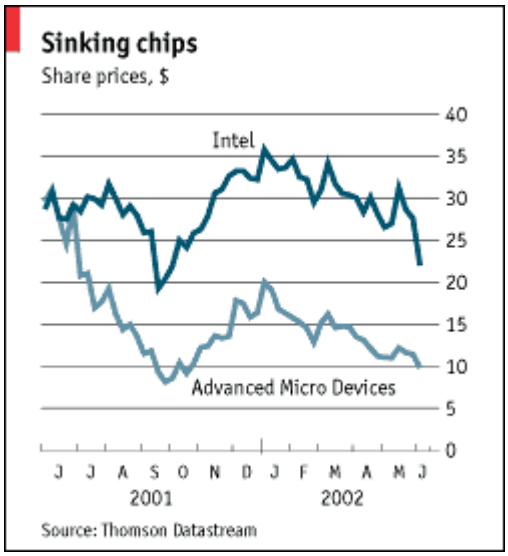
Intel in slide

Jun 13th 2002
From The Economist print edition

Do disappointing revenues mean Intel's glory days are over?

THE world's largest chip maker inspires an almost religious fervour among investors. With over four-fifths of the market for microprocessors, the number-crunching chips that power computers, Intel has a commanding view of the industry, and can predict every quarter's sales and revenues with uncanny reliability. This consistency, combined with annual revenues of $26.5 billion and profit margins of around 50%, makes Intel an investor's dream. But it also means the company is unduly punished when it gets things wrong.

On June 6th Intel unexpectedly issued a warning that its revenues and gross margins in the second quarter would be slightly lower than forecast. The next day, its share price plunged by 18%; it has since declined further (see chart). In part, this reflected dashed hopes of an imminent recovery for the technology sector, which had been read into Intel's better-than-expected first-quarter results. But it also led to speculation that Intel's best days might now be behind it. Such talk always starts when Intel stumbles, notes Andrew Norwood, an analyst at Gartner, a research firm. “People are always trying to say ‘this is the end of the Intel monopoly',” he says. But might they be right this time?



Intel undoubtedly faces a number of challenges. Its immediate problem is that sales of microprocessors for PCs, which account for most of its revenues, have levelled off as the PC industry has matured. After years of double-digit growth, the number of PCs sold declined in 2001, and there is little prospect of any more than slow growth in future. In a flat market, Intel's rivals, the largest of which is Advanced Micro Devices (AMD), another American company, can concentrate on boosting market share. But Intel, with a share of 81%, has little room to grow.

The company's strategy for reducing its dependence on the PC market was to diversify into chips for telecommunications equipment, networking gear, handheld computers and mobile phones. Sales in all of these areas are, however, flat or declining. Intel has dabbled elsewhere, including in digital cameras and broadband-access equipment, but to no avail. Of its $26.5 billion of revenue last year, $20 billion came from microprocessors, and most of the rest came from memory chips.

A bit better

Intel is now pinning its hopes on Itanium, a 64-bit microprocessor that handles data in larger chunks than its 32-bit Pentium chips. This makes Itanium suitable for use in powerful servers, mainframes and supercomputers—markets in which sales volume is lower, but margins are fatter. So far, however, Itanium has failed to impress. The first version of the chip, launched a year ago after a decade of development, was woefully slow, and sales were unimpressive. Itanium 2, which will be launched next month, runs twice as fast.

To exploit Itanium's 64-bit capabilities, however, computer makers will have to design entirely new machines around it, and software companies will have to produce new versions of their programs. This is starting to happen, but it will take some time. Itanium is unlikely to provide a surge in revenues any time

soon.

Meanwhile, perhaps the greatest threat to Intel is competition from AMD, whose Intel-compatible microprocessors are increasingly popular with PC makers and buyers. The two firms have traded blows over the years, with Intel's market share falling from 88.5% in 1997 to 76% last year, before rebounding to its current 80% or so. This suggests that a steady decline in Intel's market share is not inevitable. Much of AMD's increase in market share has come from price-cutting. With a research and development budget six times the size of AMD's, Intel ought to have no trouble keeping its smaller rival at bay. But there is trouble brewing in the form of AMD's 64-bit chip, called Hammer, which will be launched later this year.

Technically, it is unfair to compare Hammer to Itanium, says Dean McCarron of Mercury Research, a market-research firm. Hammer is a 64-bit version of AMD's existing 32-bit chips, and is intended for use in desktop machines and low-end servers. Itanium, in contrast, is an entirely new design, intended for high-end computing. The problem for Intel is that Hammer is very fast, and can run existing 32-bit software and new 64-bit software side by side. Itanium is slower and less flexible when running 32-bit software. Nor is it intended for use in desktop machines.

The nightmare scenario for Intel, says Mr McCarron, is that PCs based on the Hammer chip will eat into the market for Intel's Pentium chips. No doubt AMD's marketing department will make much of the fact that Hammer is 64-bit, while the Pentium is only 32-bit. The obvious thing for Intel to do would be to respond with a whizzier, 64-bit version of the Pentium. Such a chip is said to be under development, just in case. But the launch of a 64-bit Pentium would undermine the case for Itanium, and cannibalise its sales. Hammer thus poses an indirect threat to Itanium.

Intel's huge resources mean it could survive even the failure of Itanium, which is a distant possibility. The company's size enables it to finance developments that no rival can. So big are its revenues and margins that even if it lost 20 percentage points of market share and ten points of margin, says Mr Norwood, it would still be in an enviable position.

In short, Intel is likely to maintain its position at the top of the industry for some years to come. But when you are at the top, the only way is down.

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Space tourism

Starstruck

Jun 13th 2002
From The Economist print edition

Can celebrities help make space tourism a profitable proposition?

AS A boy, Lance Bass dreamed of being an astronaut. Today, as any teenager knows, Mr Bass is the third-cutest pop star in NSYNC, an American boy-band. Now, the 22-year-old pin-up wants to cash in on his celebrity by taking a trip to the International Space Station (ISS).

So far, a grand total of two “space tourists” have been to Station Alpha, courtesy of the Russian Space Agency and an Arlington-based firm called Space Adventures that acted as intermediary. Both tourists paid for the $20m ticket from their own cavernous pockets. But if Mr Bass's bid is successful, it will be paid for by a combination of media productions and retail sponsorship. And if this works, it may lead to more of the same.

David Krieff, president of Destiny Productions, a Los Angeles-based television production agency, claims that his company has the money to back Mr Bass's bid, and touts a business model that will support similar celebrity trips in future. The idea is to raise $25m for the trip, a chunk of which would be used to produce a ten-show TV series showing the five months of training through to launch, plus the trip itself. The whole package would include corporate sponsorship, product placement and grassroots retail promotions. If he gets there, Mr Bass may even sing. Mr Krieff claims that another eight “huge A-list stars”, including one supermodel, have expressed an interest in similar ventures.

As far as the rest of humanity goes, ever since the persistent Dennis Tito secured his place as the first tourist in space, he has become a rallying point for enthusiasts trying to get access to space for a broader (ie, poorer) range of customers. Initial market studies, including one by NASA, have suggested that space tourism is potentially a multi-billion-dollar market.

The single greatest barrier has always been the price. At present, the most credible efforts at cheaper transport are in the area of “suborbital” flights. Dozens of companies are attempting to build prototype vehicles that would take tourists to the edge of space. Space Adventures has already taken 100 deposits, and some full payments, for flights on these unbuilt vehicles. They would take tourists to at least 62 miles (100 kilometres) in altitude, near the very edge of the earth's atmosphere. By comparison, passenger jets cruise at an altitude of about six miles.

Eric Anderson, Space Adventures' boss, says his company is confident that there would be “thousands” of customers willing to pay $100,000 for a 30-90 minute space experience, including five minutes of continuous weightlessness. A recent poll by Zogby International, a market-research firm, found that 19% of well-off Americans would be prepared to spend $100,000 on a short suborbital flight. The first flying prototypes, costing $10m-20m each, could be ready in as little as two years, says Mr Anderson. It would take another 18 months of testing before paying customers could get their space wings.

As for Mr Bass, time is running out to finalise a deal for the November flight to the ISS, as he needs five months of training. But if he succeeds, expect to hear more about space's youngest star—and expect other famous faces to embrace the final frontier.

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Corporate restructuring in South-East Asia

Timid tigers

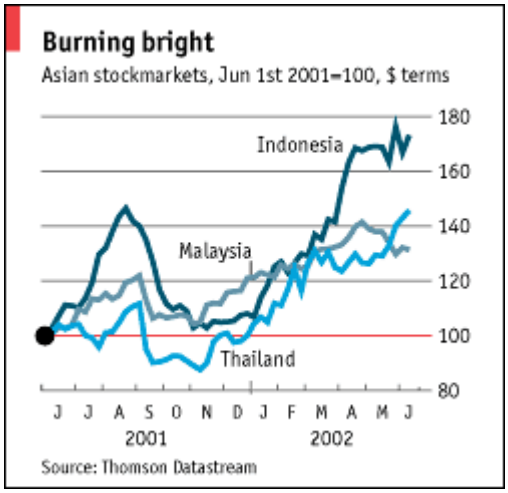
Jun 13th 2002 | BANGKOK, JAKARTA AND KUALA LUMPUR
From The Economist print edition

Companies are starting to shape up, but politics continues to cast a shadow over business

The political puppetry of Asian business

ON THE face of things, the current tussle over the Philippine assets of First Pacific, a South-East Asian conglomerate, represents a jolt for the region's corporate culture. Indonesia's Salim family, the biggest shareholders in First Pacific, which is listed in Hong Kong, are admitting defeat and unwinding some failed investments. The property and telecoms industries in the Philippines may now undergo an invigorating consolidation.

The Philippines is not the only country to experience a corporate shake-up recently. The Malaysian government has turned its conglomerates upside down, replacing politically connected bosses with professional managers. In Thailand, a few big firms are restructuring voluntarily. Indonesia, the perpetual laggard, has dropped a plan to go soft on corrupt and indebted tycoons and brought in a new, supposedly more scrupulous team to sell the state's industrial assets. Investors certainly seem to think the region has turned a corner: its biggest stockmarkets have soared this year (see chart).



But the case of First Pacific also shows how limited the progress has been so far. Some assets will change hands, but both parties are still massive family conglomerates. The deal seems to be driven less by market pressure than by backroom chumminess, doubtless spurred by the fact that both buyer and seller are from the same region of China's Fujian province.

The picture is similarly mixed when it comes to corporate governance. Since the economic meltdown of 1997, South-East Asia has seen a tightening of accounting standards and stockmarket regulation. But new laws and regulations still require firmer and fairer enforcement. Above all, no country in the region has succeeded in insulating business from politics.

Take Malaysia, where efforts at reform look the most radical. Since last year, the stock exchange has required all listed companies to disclose details of their compliance with a new code of corporate governance. Directors of listed firms must now take courses on their responsibilities. CLSA, an investment bank owned by France's Crédit Lyonnais, awards Malaysia nine out of ten for its rules on corporate governance. Over the past year, Malaysia's government has pushed debt work-outs, management shake-ups and an unravelling of corporate cross-holdings among the country's conglomerates.

Last July, the government bought Renong, the country's most indebted company, with no special sweeteners for Halim Saad, the owner-manager. More recently, the police have investigated fraud at the national airline during the tenure of Tajudin Ramli, a businessman who had profited handsomely from the government's deliberate coddling of ethnic Malay entrepreneurs. State-owned Telekom Malaysia is also manoeuvring to salvage TRI, the country's second-largest mobile-phone operator, from Mr Tajudin's empire.

But Malaysia's government still tolerates murky dealings when it suits: last year, for instance, it sold a stake in the post office without any sort of public tender. Many critics insist that the new, professional managers being brought in to run companies are just another set of cronies.

In Thailand, too, the picture is mixed. Most listed firms now have respectable numbers of independent directors. A revision of the bankruptcy law has helped to resolve some of the country's suffocating corporate debt. But the new law has drawbacks. The definition of bankruptcy arguably gives debtors too much legal leeway, for instance. Listed companies continue to do dubious business with related parties. In one recent example, BECL, a construction firm, bought 15% of Bangkok's unfinished subway from its affiliate, Charoen Karnchang, which is both an investor and a contractor in the project.

By far the worst abuses occur in Indonesia. Firms change the dates of annual meetings, or hold them in remote locations, just to put awkward shareholders off the scent. Although the stock exchange recently ruled that all listed companies must have independent “commissioners”, it failed to define the term, rendering the measure useless. Moreover, the courts remain horribly corrupt.

Family matters

If regulators, courts and investors cannot instil new practices, South-East Asian businessmen are unlikely to adopt them voluntarily. Family ownership remains widespread, and family members often serve as senior managers. Central, a Thai hotel and department-store chain, boasts more than 30 executives from the controlling family. Another Thai conglomerate, Charoen Pokphand, holds itself out as a model of corporate reform, simply because outside managers outnumber family ones. Charoen Pokphand also illustrates how tenacious the conglomerate model remains. The group is considered the embodiment of strategic focus, because it has whittled its holdings down to just nine main businesses.

Terence Gomez, a Malaysian academic, points out that most firms in the region have restructured only under duress. Businessmen who emerged solvent from the crisis see little reason to change their ways; those who went bankrupt blame their governments, the IMF, George Soros—anything, in short, but their own business practices. There are a few exceptions. Siam Cement, a Thai conglomerate, has sold some 40 subsidiaries to reduce its debt and concentrate on its cement and chemicals businesses, for instance. But for every reassuring tale, there are plenty of hair-raising stories. Prachai Leophairatana, the former owner-manager of Thai Petrochemical Industries, Thailand's biggest corporate debtor, was ousted only after a three-year court battle, and has filed no fewer than 28 lawsuits against the new management.

Some sanguine analysts believe that South-East Asian businesses will become more transparent of their own accord, as they seek to win cheaper financing and raise their share prices. CLSA calculates that the shares of Indonesian firms with good corporate governance performed twice as well over the past five years as those of the average listed company. A recent study by McKinsey, a consultancy, found that shares of better-run Thai firms commanded a 20% premium over other companies listed in Bangkok.

But that incentive applies only to independent firms, not to conglomerates that still account for so much business in the region. If a company is only one part of a corporate empire, the benefits of bilking creditors and minorities can far outweigh any damage done to the share price. Consider, for example, Asia Pulp & Paper and its affiliates. Between them, they lent over $1.2 billion to other companies linked to Indonesia's Widjaja family.

It is only thanks to political pressure that any of South-East Asia's corporate crooks are being brought to book. The reshuffle in corporate Malaysia dates to the sacking last year of the finance minister, Daim Zainuddin, who had surrounded himself with corporate cronies, such as Mr Tajudin and Mr Halim. The clean-up comes at the behest of Mahathir Mohamad, the prime minister. His current intervention might be for the good, but it also shows that politics still dominates Malaysian business. Indeed, Dr Mahathir has virtually guaranteed that cronyism will continue by retaining his policy of promoting ethnic Malay entrepreneurs.

In Indonesia, politics has stymied attempts to reform big business. The country's bank-restructuring agency is under such pressure that it has churned through no fewer than seven bosses in four years. None of the tycoons who stole billions of dollars of public funds intended to recapitalise banks during the Asian crisis has ever been prosecuted. Indeed, the only person to have been tried in that affair was the governor of the central bank. He was found guilty, but remains in his post.

The risk of political meddling in Thailand's economy, meanwhile, seems to be growing. Thaksin

Shinawatra was the country's richest man until he passed his telecoms business to his son and ran successfully for prime minister. His cabinet contains another telecoms tycoon, among other businessmen. Although Mr Thaksin insists he has nothing to do with it, telecoms reforms have made remarkably little progress since he came to power. But the government found time to fiddle with the telecoms laws to the detriment of the prime minister's business rivals, before reversing itself in the face of a public outcry. Funny to think that it was Mr Thaksin himself who declared 2002 the “year of corporate governance”.

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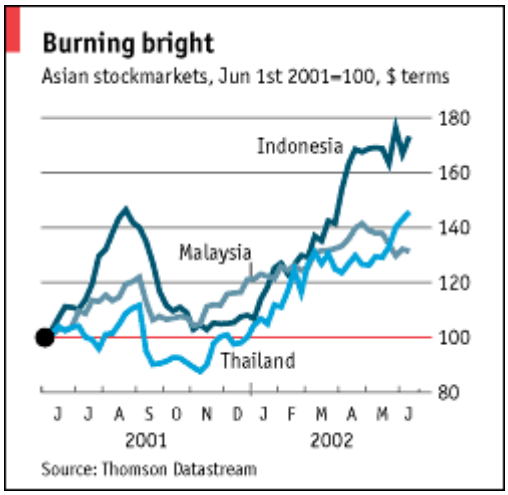

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Corporate governance

Designed by committee

Jun 13th 2002 | NEW YORK
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How can company boards be given more spine?

“COOTE got me in as a director of something or other. Very good business for me—nothing to do except go down into the City once or twice a year to one of those hotel places—Cannon Street or Liverpool Street—and sit around a table where they have some very nice new blotting paper. Then Coote or some clever Johnny makes a speech simply bristling with figures, but fortunately you needn't listen to it—and I can tell you, you often get a jolly good lunch out of it.”

The blotting paper has vanished. But to judge by the crop of scandals currently tormenting American business, little else about life in the boardroom has changed since Agatha Christie wrote “The Seven Dials Mystery” in 1929. As some of America's best-known bosses lied, swindled and defrauded their way through hundreds of millions of shareholders' funds in the effervescent late 1990s, boards of directors, supposedly the guardians and protectors of shareholders' interests, appear to have snoozed through it all.

Dennis Kozlowski, recently ousted from the top of Tyco, an ill-fitting conglomerate, stands accused of evading taxes on fine art, which his board may have lent him the money to buy. Bernie Ebbers, former boss of WorldCom, a telecoms firm, persuaded his board to lend him hundreds of millions of dollars so that he could bet on his company's share price. The board of Adelphia, a publicly owned cable company with a stock worth little, put the company's name on $2.3 billion-worth of bank loans to the founding family, which owns one-fifth of the shares. Not to mention Enron, whose board rode roughshod over its own rules in order to allow Andrew Fastow, its chief financial officer, to benefit personally from the off-balance-sheet vehicles that he set up.

Scandal leaps from company to company with bewildering speed, and as share prices collapse the lawsuits mount. Directors are in the front line. PricewaterhouseCoopers, an accounting/consulting firm, has counted almost 500 securities lawsuits filed by investors in the past year. Marsh, an insurance firm, reports that the premiums that companies pay to insure their directors against lawsuits have shot up by between 35% and 900% recently, depending on the business. Companies at greatest risk, says Steve Anderson of Marsh, could be paying $2m a year for a $10m policy—if they can find an insurer willing to underwrite the risk at all.

“What to do when you become a target of the SEC” is the topic that exercises the latest issue of *Directors & Boards* magazine. The SEC, meanwhile, is urging state and federal prosecutors to bring more criminal cases against securities-law violators, and on June 12th it voted to introduce a new rule requiring chief executives to vouch personally for their companies' financial statements. America's boards have been in scrapes before. Never, however, has their reputation sunk so low.

European concerns

With such forces on the loose, even boards themselves have begun to understand that something needs to be done. And not only in America. Corporate governance is a hot topic around Europe too. The scandals there may not have been as great as on the other side of the Atlantic, but recent experience in America has helped to highlight an issue that has been on Europe's corporate agenda for some time.

In Britain, a former director of the Prudential insurance company, Derek Higgs, was appointed by the government in April to head a review into the role and effectiveness of non-executive directors (more or less equivalent to America's independent directors). On June 7th, Mr Higgs issued a consultative document inviting comments on, inter alia, whether existing relationships with shareholders need to be strengthened, and on what can be done to attract and recruit the best people to non-executive roles. He is due to report by the end of this year.

One person from whom he will not need to canvass views is Lord Young of Graffham, a former trade minister in Margaret Thatcher's government. As outgoing president of the Institute of Directors, Lord Young shocked an audience in April by suggesting that non-executives can do more harm than good and should be abolished. George Cox, the institute's director-general, had to explain sheepishly that Lord Young's views did not reflect the official views of the institute. “We believe non-executives have a valuable role to play,” affirmed Mr Cox.

In Germany, where companies have two boards—a supervisory board of non-executives and a management board responsible for running the company—a government-appointed commission issued a code of corporate governance in February. Most attention was focused on a suggestion that companies publish top managers' pay, hitherto regarded as a private matter. But the longest section of the code was concerned with turning supervisory boards into better watchdogs. They should, it suggests, contain no more than two ex-members of the management board. Their work should be delegated to small, competent committees; and no member of a management board should sit on more than five supervisory boards of unrelated companies.

Self-correction? 1

% of directors answering “Yes”*

	2000	2001
Does your board have written guidelines on corporate governance?	69	75
Does the board have a formal process for evaluating CEO performance?	64	67
Does the board have a formal committee that reviews corporate governance and board operations?	60	65
Is the entire board's performance formally evaluated on a regular basis?	40	42

Source: Korn/Ferry International *Survey of more than 1,000 directors of *Fortune*-listed companies

In such countries as France and Italy, the issue of corporate governance has yet to come to the fore. Many of the biggest public companies in these countries—from LVMH to Fiat—still have large family shareholdings, family representatives among their senior management, and strong family representation on their boards. In France, it has been claimed that only about one director in five on the boards of public companies is truly independent.

Such a structure may help to resolve the perennial conflict between owners and managers. But it limits the role of the board as a check on management. It also leads to even greater cosiness among leading businessmen, who love to appoint each other to be external directors of their boards. For example, Bernard Arnault, chairman of LVMH, a luxury-goods group and one of the largest companies in France, sits on the board of Vivendi Universal, a media group that is also among the largest companies in the country. The chairman of Vivendi Universal, Jean-Marie Messier, in turn sits on the board of LVMH. In Italy, the high-level business and financial club of directors is known as the *salotto buono*, literally “the good drawing-room”. It's that cosy.

East Indian origins

One reaction to the corporate scandals in America has been to seem to act tough, in the hope of

restoring investor confidence. In this spirit, the New York Stock Exchange (NYSE) published on June 6th a set of proposals for new boardroom standards for its listed companies. These include everything from boardroom “executive sessions” without the boss to mandated “orientation programmes” (including a field trip to corporate headquarters) for incoming directors. Institutional investors, corporate-governance activists, regulators, corporate lobbies and Congress are all jostling for position with ideas for reform.

Working against this, meanwhile, is a countervailing impulse to protect the best bits of the existing system from poor, or unnecessary, regulation. The periodic worry that America may be asking too much of its boards has begun to return. Headhunters such as Spencer Stuart and Korn/Ferry say that, as the legal risks rise, emptying chairs around the boardroom table are getting harder to fill. Others warn that shackling the boss with an interventionist board may threaten America's entrepreneurial business culture.

The origins of the board lie in the 17th century among early forms of the joint-stock company, notably the English East India Company. After merging with a rival, it organised itself into a court of 24 directors, elected by and reporting to a “court of proprietors”, or shareholders. America has dabbled with other models of governance from time to time. In the 1920s, the chairman of General Electric, Owen Young, pushed the idea of stakeholder boards. But since the rise of pooled investment savings in the 1940s and 1950s, the trend has been towards the East India Company model, with the board accountable to shareholders. Corporate law, the courts and activist institutional investors such as Calpers (which began publishing lists of “underperforming” boards in the 1980s) have further entrenched the shareholder model.

One strand of history traces a push by shareholders for greater board independence. In the 1970s, many shareholders became particularly upset by public companies whose boards were beholden to powerful private interests, often the founding family. These sorts of tension still linger. Bill Ford, the boss of Ford, did not get his job on merit. And until last month, Adelphia's board accommodated no fewer than four members of the Rigas family—the company founder, John Rigas, and his three sons. “There should never be more than one Rigas on any board,” comments Dennis Block of Cadwalader, Wickersham & Taft, a Wall Street law firm.

Modern problems of board independence tend to be more nuanced than this, although not hugely so. In America, the chief executive tends to chair the board. In good times Americans heap praise on the strong business leadership that such a system cultivates. But during bad times, they fret about the worrying lack of spine elsewhere around the boardroom table—the “nodders and yes-men”, as the author P.G. Wodehouse once called them.

This matters particularly in America, where the tyrannical corporate leader is a well-established figure. John Patterson, once boss of NCR, a computer company, fired an underperforming executive by removing his desk and chair, parking it in front of the company's factory, and having it soaked in kerosene and set alight in front of the poor man. Armand Hammer, when boss of Occidental Petroleum, kept signed, undated letters of resignation from each of his board directors in his desk. Among Jack Welch's top tips for bosses: never put an academic in charge of your compensation committee. They are more susceptible to envy than rich old men.

Sure enough, in the midst of the latest corporate-governance disasters stand the usual feudal-baron types—such as Mr Kozlowski of Tyco, Mr Ebbers of WorldCom and Gary Winnick, the founder of Global Crossing, a bust telecoms firm. These burly ex-sports jocks get things done quickly. But they also tend to bully their boards into meek docility. The symptoms are clear: egomaniacal corporate strategies and extravagant personal rewards. IBM's board recently rewarded Lou Gerstner on his retirement from the chair not with the stereotypical gold watch but with $100m-worth of company stock.

Most people reckon that one of the board's most important duties should be to plan a replacement for the boss should he die or need to be jettisoned. Yet many boards seem to lack the backbone even to raise this topic. “It is surprising and distressing how few boards have a clearly thought-out process,” says Don Gallo of Sibson Consulting Group. “I think it's a huge failing in their fiduciary duties towards shareholders.”

Tyco and other companies have chosen to bring back former chief executives when they have lost their bosses, a clear sign (if not conclusive proof) that their boards had no plan for succession. Nell Minow of The Corporate Library, a watchdog website, recalls talking to board directors of a public company who got into a shouting match with the boss about succession. “His policy was: ‘I'm not going to die',” says Ms Minow.

Reformers start with the way in which directors get elected. “The CEO puts up the candidates, no one runs against them and management counts the votes,” says Ms Minow. “We wouldn't deign to call this an election in a third-world country.” In theory, shareholders can put up their own candidates, in what is known as a proxy contest. But proxy fights are exorbitantly expensive. The recent tussle at Hewlett-Packard between its boss, Carly Fiorina, and Walter Hewlett, a dissident board director, may have cost the company's shareholders $150m.

Changing faces 2

% of boards with one or more of the following:*

	1995	2000
Retired executive (other companies)	75	91
Investor	73	87
CEO/COO (other companies)	82	83
Woman	69	74
Ethnic minority	47	65
Academic	53	56
Former government official	54	52
Commercial banker	28	28
Non-US citizen	17	15

*Survey of more than 1,000 directors of *Fortune*-listed companies
Source: Korn/Ferry International

As the incumbent management has the corporate coffers at its disposal, this expense tends to make proxy fights one-sided affairs: even the smallest of Hewlett-Packard shareholders reported receiving 20 or more calls from the company. As a final blow to shareholder activists, the courts in Delaware, where the majority of American companies are incorporated, found insufficient evidence that Ms Fiorina had unfairly coerced a big shareholder, Deutsche Bank, despite hints to the contrary. Proxy contests happen at less than 1% of public companies each year in America.

The British and Canadian solution to the overbearing boss is to split the role of chief executive from that of chairman of the board, a post that can then be filled by a “lead” independent director. This idea has found some support in America. Harold Williams, a former chairman of the SEC, championed it in 1978. Institutional investors, says Roger Raber of the National Association of Corporate Directors, are keener than ever before to split the roles. But support among companies, says Mr Raber, is going the other way. They say they fear conflict in the boardroom, threatening precious “collegiality”.

The NYSE is thought to have toyed with the idea of a separate chairman, but it does not appear in its published proposals. The exchange is, however, proposing new standards for director independence, along with a requirement that all boards contain a majority of these newly defined independent directors. (Almost all American boards already have a large majority of non-executive directors.) The NYSE's proposed executive sessions without the boss ought to give directors a chance to escape the perils of “groupthink”, intimidation and what Victor Palmieri, a crisis-management expert in the 1980s, called a “progressive loss in the collective grasp of reality”. Companies seem to hate the idea of executive sessions—which might mean they could actually work.

Some embrace these reforms as part of a creeping “professionalisation” of the board. This need not mean that the job becomes full-time. But it does mean raising and standardising the qualifications for joining a board. Part of the NYSE's answer to the proliferation of accounting scandals among listed companies, for instance, has been to set clearer and more detailed qualifications for board directors who serve on audit committees.

A director's lot

To get the right people, consultants say, their pay may have to rise. Outside the top 100 companies in America, whose directors typically earn $250,000-300,000 a year, the rest make do on $50,000-75,000. The consultants point out that exchanges, regulators and Congress have been heaping extra burdens on the board for years. Boardroom committees, for instance, have proliferated. Even audit committees were uncommon 20 years ago. Now any board worth its salt needs a compensation committee, a nomination committee, a finance committee, a public-policy committee and now a governance committee as well.

This creates unrealistic expectations among investors, say critics. No director can be expected to catch sophisticated fraud by company insiders. The head of Enron's audit committee, Robert Jaedicke, is a professor of accounting at Stanford University, who could hardly have been more qualified for the job. “Shit happens,” says one Wall Street financier. He calls the NYSE proposals “a lot of nonsense”.

The most powerful catalyst for change ought to be the big institutional investors that have their own fiduciary duty to protect their investors. Right now, these institutions are busily blaming boards for recent wrongs. But this seems rather convenient. One of the more interesting features of the assorted revelations now scandalising the market is that many of them are hardly news. Everybody suspected that America's energy-trading companies inflated their revenues. Software-contract accounting was an acknowledged black art. And the fact that telecoms firms bought from each other to boost their numbers

has shocked nobody but neophytes. The big institutions knew who the cheats were. But life was good, and they nodded and winked and chose to go along with it. In many ways, they now have nobody to blame but themselves.

As part of its reforms, the NYSE proposes to give shareholders more opportunity to monitor and participate in governance. This includes allowing them to vote on stock and stock-option plans for bosses, and making companies disclose codes of business conduct and ethics on their websites. In Delaware, judges seem more willing to put their faith in the judgment of sophisticated institutions, and may increasingly throw open contentious issues to a vote. When it comes—as it inevitably will—the next wave of corporate scandals might put institutions, not boards of directors, in its crosshairs.

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Hunger

Always with us

Jun 13th 2002 | ROME
From The Economist print edition

AP

Good governance in poor countries would end hunger faster than rich-world aid

A GATHERING at which President Robert Mugabe of Zimbabwe is able to lecture world leaders on “fast-track land acquisition” as a route to rural reform was always going to be something of a circus. The World Food Summit, convened this week in Rome by the Food and Agriculture Organisation (FAO) of the United Nations, was meant to assess progress made since the previous summit, six years ago, which eagerly promised to halve the number of hungry people in the world by 2015. Progress has been slow. At current rates, the goal will not be reached until 2030 at the earliest. Although hunger has fallen sharply in China, it has risen in sub-Saharan Africa—thanks partly to AIDS, civil war and bad weather, and partly to Mr Mugabe and other pursuers of benighted policies.

Getting a grasp on the size and distribution of the problem is, admittedly, tricky. Outright starvation, arising from strife or natural disaster, is a graphic affliction to which the world responds fairly swiftly. The World Food Programme, for example, delivered 2.7m tonnes of emergency food aid to 43m people last year.

On the other hand, chronic hunger—a steady lack of enough safe and nutritious food to maintain physical or mental well-being—is a less visible condition, even if a far more common and complex one. It is not just a matter of too few calories to fuel development and activity, but also too few micro-nutrients, such as iron, to keep the body running at full tilt. Its long-term impact can be devastating. The effects of hunger start before birth, as malnutrition in pregnant mothers causes problems for children in later life. In young children, malnutrition stunts mental and physical development, later hobbling them at school. It contributes to 5m childhood deaths a year, mainly through susceptibility to such diseases as pneumonia.

Apart from the moral dimension of deprivation, there are the economics to consider. The FAO reckons that halving hunger by 2015 would yield $120 billion-worth of gains a year from longer, more productive lives. If such assessments are crude, they underscore that hunger is not only a symptom of poverty, but a cause of it too.

The FAO reckons that halving hunger by 2015 would yield $120 billion-worth of gains a year from longer, more productive lives

Better estimates and clearer strategies will come only from more accurate measures of the number of chronically hungry and where they live. With wide margins of error, the FAO reckons that 780m people in developing countries are undernourished, only a little down on 820m a decade ago. South Asia accounts for something over two-fifths of the world's hungry. Sub-Saharan Africa has the highest proportion of hungry people: every third person, on average, goes hungry.

The FAO bases its calculation on the amount of food available in a country, from domestic production and imports, rather than on how much people actually eat. The International Food Policy Research Institute in Washington, DC, says that an analysis of household surveys, which looks at how much food reaches family members and is now complete for a clutch of African countries, paints a more nuanced picture than the FAO's. It tallies more closely with other measures of malnutrition, such as the number of underweight children in a population. Pinpointing the hungry should improve the deployment of scarce resources.

Even putting food on the table does not mean that everybody will get a fair share. In South Asia—notably India, Pakistan and Bangladesh—half of all young children are malnourished, compared with a third in poorer sub-Saharan Africa. The institute's research shows how women in South Asia have less power at home, relative to men, than do African women. So they get less to eat, as do their children, both in the womb and in later life.

Hungry for change

Boosting poor-country agriculture is critical for tackling hunger. Simply shipping food from rich-country surpluses does little to improve the prospects of the world's desperately poor, three-quarters of whom live in rural areas and depend on farming for their income. Higher agricultural productivity and better access to markets will help these people. Although biotechnology is sometimes touted as a miracle boost for farming, the most effective fixes, in sub-Saharan Africa at any rate, are decidedly low-tech: fertiliser, irrigation, better seeds, fitter livestock, more teaching of farming skills, more roads, better access to credit and more secure land tenure.

What of international initiatives? The FAO wants action by rich and poor countries through its International Alliance Against Hunger, bringing together governments, non-governmental organisations and the private sector to find ways of boosting the agricultural productivity of small farmers in poor countries, as well as to provide direct assistance for 200m of the world's hungriest people. It reckons that using this two-pronged approach to meet the 2015 target could cost roughly an extra $24 billion a year. That will require a doubling in overseas aid to agriculture.

The World Bank is also drawing up a new rural development strategy. A homegrown initiative from African leaders, called the New Partnership for Africa's Development, includes farming as a route to economic growth. Little money or manpower, however, has yet materialised. This week, America revived its own Partnership to Cut Hunger and Poverty in Africa, announcing a modest $30m rise in foreign assistance for agriculture and rural development this year, with hopes of attracting some of the additional $5 billion in overseas aid that President George Bush recently promised.

America's largesse is tempered by its new farm bill, which poor-country leaders point out takes with one hand what is given with the other. Domestic farm support, import quotas and rising tariffs and export subsidies in rich countries greatly hamper poor countries' agricultural exports to rich markets—as well as distorting markets at home. The World Bank reckons that, if the rich world pulled down its trade barriers in agriculture, developing countries would be over $30 billion a year better off by 2005. Yet it is not only rich countries holding poor ones back. According to the bank, trade liberalisation within the developing world itself could yield over $110 billion a year in extra income for low-income countries.

In the end, beating hunger is as much or even more to do with good governance in poor places, with sensible policies needed for education and health care as well as agriculture, as it is to do with access to money and technology from afar. That is hardly a secret recipe. Yet too few countries have mastered it.

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Zimbabwe's currency laws

Bonkers

Jun 13th 2002 | HARARE
From The Economist print edition

How Zimbabwean farmers unwillingly subsidise their government

Reuters

Fragrant weed, stinking business

DESPITE the violent invasion of their fields by machete-wielding supporters of Robert Mugabe, Zimbabwe's tobacco farmers raised a bigger-than-expected crop this year. Plump bundles of the weed sell at auction in Harare for the healthy price of $1.65 a kilo. The farmers, who are the country's largest exporters, should be content. They are not, because the government is grabbing most of their takings through a rigged exchange rate.

The local currency, the Zimbabwe dollar, has been pegged at 55 to the American dollar for nearly two years, despite inflation of over 100%. If the black market is anything to go by, the Zimbabwe dollar is overvalued by a factor of ten. Yet tobacco farmers have to surrender all hard-currency receipts to the government, which pays them at the official rate in nice, freshly printed Zim dollars. To avoid hard feelings, the government gives them a subsidy that boosts their takings by four-fifths, but this does not nearly cover their costs.

Zimbabwe's currency rules serve two purposes. One is nationalistic: some ministers argue that devaluation would be a surrender to western imperialism. The second is practical. Mr Mugabe's cronies use their connections to obtain hard currency at the official rate and then sell it on the black market for a tenfold mark-up. The finance minister, an amiable technocrat named Simba Makoni, admits that the peg has had “serious repercussions on export competitiveness”, and has called for a managed float. But the rest of the cabinet has, for some reason, ignored him.

Ordinary Zimbabweans do their best to dodge the rules. Households and companies have been shifting money out of the country, by understating export receipts or simply flying to London with cash sewn into their coats. At last year's tobacco auctions, foreign buyers found that nothing prevented them from paying in local currency, so they changed their American dollars on the black market and snapped up some phenomenal bargains.

This year, all payments must be made in hard currency, direct to the government. Tough border controls and frequent roadblocks stop farmers smuggling their bulky product out of the country. Indeed, a lot of innocent commerce has been criminalised. A senior opposition politician was arrested last month for trying to take a truckload of maize to his farm, to feed his hungry workers. Basic foods are subject to price controls and a state monopsony—the police said he should have sold his maize to the government, for distribution to the poor (ie, ruling-party supporters).

Before March's presidential election, the Zimbabwe dollar was buoyed by the repatriation of some of the funds that politicians had squirrelled away in foreign bank accounts—they feared that these might be frozen by sanctions against the regime. Since Mr Mugabe managed to steal the election without attracting more than mild sanctions, the elite feels more secure. The country's productive citizens, meanwhile, faced with the prospect that their rulers will never surrender power, are in despair. Hence the Zimbabwe dollar's freefall over the past couple of weeks, from 300 to the American dollar on the black market to 500. The black market is no longer fuelled by firms that need to import spare parts. One businessman says that “it is simply people getting whatever they can out of here”.

Mr Makoni says he fears the economy will contract by 10% this year. To put this into perspective, GDP in Congo, where Mr Mugabe's army, along with various others, is fighting a calamitous war, shrank only half as fast last year.

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Economic parallels between America and Japan

Terrible twins?

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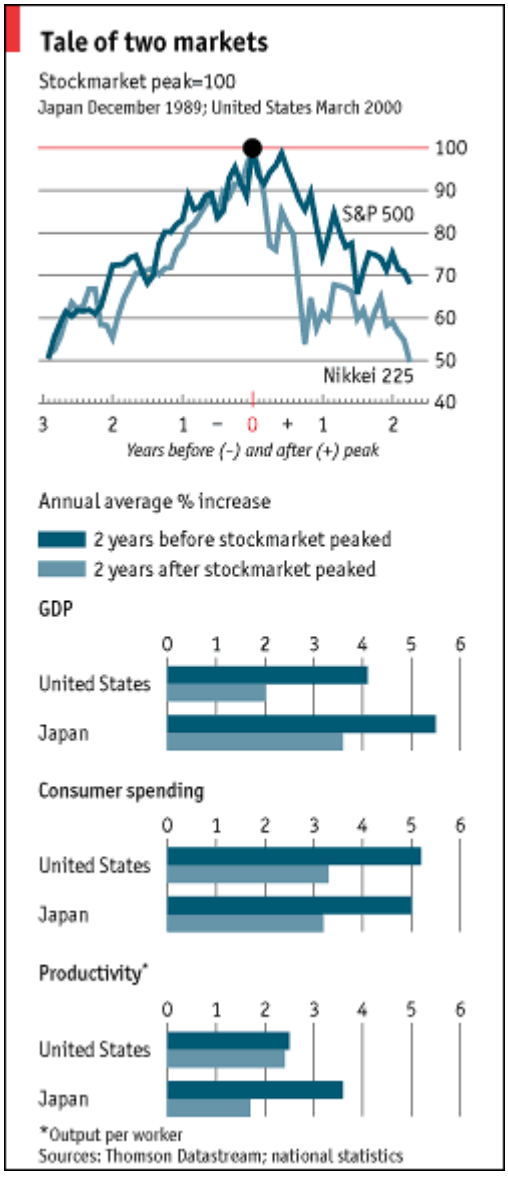
America's economy looks awfully like Japan's after its bubble burst

JAPAN'S economy rebounded at an annual rate of 5.7% in the first quarter of this year, a shade faster than America's. Unfortunately, many economists distrust Japan's notoriously volatile statistics: they expect output to fall again in the current quarter. More than 12 years since Japan's stockmarket bubble burst in December 1989, its economy remains fragile. Meanwhile, America appears to have survived the bursting of its bubble in 2000 rather better—so far.

The similarities between America's financial bubble in the 1990s and Japan's in the 1980s have been well rehearsed. In both cases, share prices and capital spending soared; households and companies went on a borrowing binge. Japan, like America a decade later, enjoyed a spurt in productivity growth, suggesting to some that it had a superior economic model.

Yet the conventional wisdom now is that the economies have taken divergent paths since their bubbles burst. Thanks to resilient consumer spending, America is widely tipped to enjoy robust growth this year and next. Meanwhile, Japan is expected to languish in perpetual recession.



Look again. America's economy over the past two years has in many ways mirrored the performance of Japan's immediately after its bubble burst (see charts). In the two years from December 1989, Japan's stockmarket fell by 40%, slightly more than the 33% fall in the S&P 500. Japan's economy held up well during those two years. GDP growth did not turn negative until 1992. Capital spending slowed sharply, but consumer spending continued to boom. In fact, property prices continued to rise strongly for two years after the stockmarket tumbled. This sounds like America today, since rising house prices have bolstered consumer spending.

Economists argue that recent swift productivity growth points to robust recovery in America. Yet productivity growth in Japan was almost as brisk in 1990-91. America's troubles may still lie ahead.

Another claim is that America's Federal Reserve has eased interest rates aggressively, whereas the Bank of Japan was slow to ease and so failed to prevent deflation. The Bank of Japan has been overly cautious in recent years; but criticism of the bank's policy in the early 1990s may be unfair. Deflation did not develop until the mid-1990s. In 1990-91, Japan had a higher inflation rate than America has today.

Admittedly, Japan did not start to cut interest rates until 18 months after the stockmarket began to fall, whereas the Fed started only nine months after. Yet if monetary policies are considered in relation to growth rates, it is not clear that interest rates were cut more swiftly in America. As the lower chart shows, GDP growth was brisker in the early 1990s in Japan than it was in America last year. According to Stephen King, chief economist at

HSBC, both the Bank of Japan and the Fed began to cut interest rates during the third consecutive quarter of below-trend growth.

And what about one other popular argument in support of America's economic resilience? Japanese firms in the late 1980s used shady accounting practices to conceal financial problems. Now that could never happen in America.

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Stockmarkets

Bearish on America

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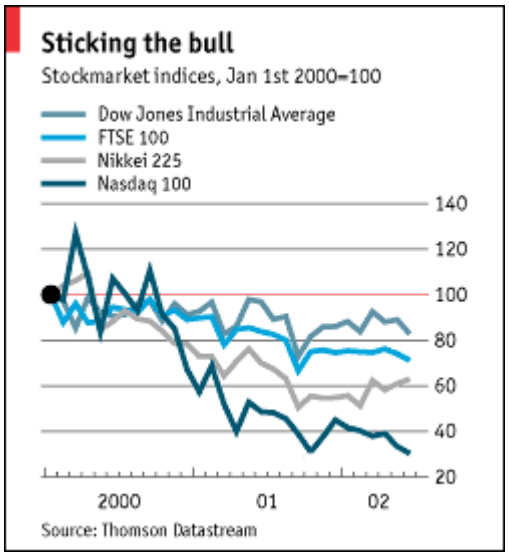
Share prices may have further to fall, above all in America

A BEAR market ends only when the last bull pulls his money out, Wall Street says. On that basis, there is still some way to go. Share analysts at American investment banks continue to trumpet “buy” recommendations—over three-fifths of all recommendations, compared with only 2.7% advising clients to sell, according to First Call, a research firm. The bull market's greatest cheerleader, Abby Joseph Cohen of Goldman Sachs, continues as usual. She says that the fair value of America's S&P 500 index is 1,300, nearly a third higher than it was on June 11th.

American stockmarkets continue to make unwelcome headlines. On June 11th, the Nasdaq 100 index closed at its lowest since January 1998. Even after the September 11th attacks, this index, heavy with the shares of technology companies, was higher than it is now (see chart). The Dow Jones Industrial Average of blue chips has also touched a post-September low, of just above 9,500; the index has gone nowhere for over three years now. Elsewhere, putting aside last September, London's FTSE 100 is at its lowest since late 1998. Germany's DAX is at its lowest since November. And Japan's Nikkei has recently given back some of the gains it made since March—and is still over 10% down from a year ago.



Implausibly high expectations are still attached to corporate profits. According to First Call, Wall Street analysts forecast profit growth of 8% this year and 20% in 2003. In the second quarter of the year, profits will probably rise, year-on-year, by just 3%. And even if these heroic predictions prove correct, share prices in America will still look high by historical measures. First Call calculates that, if 2002 profits come out as expected, price/earnings (p/e) ratios—the ratio of share prices to profits—will be 19, above previous peaks for the S&P 500 of 18 in 1968 and 1991.

Standard and Poor's, the rating agency that publishes the index, paints a dark picture, by taking into account the tendency of American firms to cut accounting corners in order to show themselves in the best light. Taking current share prices and what companies claim as their core operating profits in 2001 gives a p/e of 26. However, take total profits reported by those same firms last year—operating profits minus everything that was written off or classified as non-core—and the p/e becomes 41. Had the cost of share options been included when calculating profits, the p/e would have risen to over 50, compared with a post-war average of 15.

Not surprisingly, American and foreign investors are starting to look elsewhere for opportunities, according to Merrill Lynch's latest survey of fund managers. This is both encouraged by, and contributing to, the weaker dollar, which now poses a risk to American share prices.

But where to invest? P/e ratios are also high in most other developed markets. Hence a new enthusiasm for the shares of emerging markets. Given the awfulness of Argentina and the risks of contagion to other Latin American markets, Asia has been the main beneficiary. The South Korean market, helped by a resilient economy, has all but doubled since September. Interest grows even in Russia, up by half this year—a measure of how desperate some investors are becoming.

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Corporate crime

Prosecutor's dilemma

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Whether erring companies face civil or criminal charges affects their future

“DID you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?” So said Lord Thurlow, an 18th-century English lawyer. Today, most legal systems outside America assume that companies act through people. The authorities' usual approach to corporate crime is to pursue those responsible. Americans, on the other hand, think that companies as legal entities can be criminal. That reflects a belief that the culture of a corporation can produce malfeasance. This week, a deadlocked jury was still deliberating the guilt of Andersen, the accounting firm that stands accused by the Justice Department of criminal obstruction after the collapse of Enron last year.

The consequences for an accused company of the American approach can be severe. Clients have deserted Andersen in droves, thousands of employees have been sacked, and the firm's international network has crumbled. It is hard to see what future Andersen might have.

A retailer, say, might easily survive a criminal probe. For a financial firm, or indeed any other business that operates under the scrutiny of regulators, an indictment can be a death warrant. That helps to explain why Merrill Lynch sought a settlement last month with New York state's attorney-general, who accused the firm of misleading investors without ever charging it of a crime.

For a financial firm, or indeed any other business that operates under the scrutiny of regulators, an indictment can be a death warrant

In the American system, a government prosecutor might choose a civil over a criminal charge because it carries a lower burden of proof—a preponderance of evidence rather than proof beyond reasonable doubt. The trouble, prosecutors say, is that the penalties imposed in a civil case are far less severe than those in a criminal one. Deterrence, they say, suffers.

This sentiment has evolved slowly. The roots of the American approach date to a railroad case in 1909, when the Supreme Court asserted that if a corporation can be contractually bound by its employees, it can be bound by their criminal actions; if a company can be liable for damages, then it can be liable for crimes; and, finally, if it could not be prosecuted, wrongs would fail to be addressed.

Real zeal for the criminal prosecution of companies began to emerge during a period of enthusiastic regulation in the 1970s. It received a formal endorsement in 1999 from the Justice Department, which issued guidelines stating that “more and more often, federal prosecutors are faced with criminal conduct committed by or on behalf of corporations”. The correct response, the guidelines continued, was criminal enforcement. A surge of prosecutions has followed in areas such as antitrust, pollution and medical claims. The example of Enron has set new legislation working its way through Congress, placing criminal penalties on accounting firms for even the most benign destruction of an audit record within seven years of the audit's completion.

Awkwardly, no consistent distinction exists between an offence that should be handled under criminal law and one under civil law. Mary Jo White, now at Debevoise & Plimpton but until last November federal prosecutor for the southern district of New York, compiled a list of ten big corporate cases between the mid-1980s, when Rudolph Giuliani was district prosecutor, and her stint. In every case, the company could have been prosecuted in either way, but, as it was, five companies faced civil charges and five criminal.

In each example, litigation took a heavy toll on the company, but it was heavier for those facing criminal charges: only one of the five, Consolidated Edison, survived. Of the other four, Drexel Burnham Lambert closed, Republic NY Securities and Bankers Trust were acquired, and Daiwa Bank lost its right to do

business in America. Of the companies that faced civil charges, three survived: Prudential Securities, Sequa and Aurora Foods. The other two, Kidder Peabody and Salomon Brothers, had a shot at independence, though in the end they were bought too.

In most of these cases, Ms White says, the difference was not what the companies did wrong in the first place, but what they tried to do to put things right. If a firm was seen to make heroic efforts to clean up its act, prosecutors rewarded it by pursuing civil charges. Salomon Brothers, for example, waived client privilege, which brought with it risks of lawsuits from shareholders. Sequa, accused of improperly reconditioning aviation parts, encouraged the government's investigation into its complex technology, going so far as to foot the bill. All the companies facing civil charges made big changes in management. Companies that faced criminal charges fought hard instead. To miss this distinction is to drive nails into your coffin.

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Austrian banks

Fined begad!

Jun 13th 2002
From The Economist print edition

The European Commission makes a meal of the Lombard Club

EIGHT Austrian banks must pay fines totalling *euro*124m ($118m) to the European Union for operating a price-fixing cartel for years. Files left by a banker who shot himself in 1997 alerted the European Commission's competition authority to the activities of the Lombard Club, a group of bankers who met each month for lunch at the Hotel Bristol in Vienna. According to material seized by the commission and by Austrian police, the banks fixed lending and deposit rates, and even had sub-committees for different banking products. The Lombard Club was “one of the most shocking cartels ever discovered by the commission,” said Mario Monti, the competition commissioner, this week. Worse, they dined well.

Three of the biggest banks, Erste Bank, Bank Austria and RZB, are preparing to appeal to the European Court of First Instance. They do not deny the cartel, but they claim that it did not affect EU competition: it was confined to Austria, whose interest margins were among the lowest in Europe.

They also argue that this was no secret cartel, but the relic of an official instrument of economic control set up long before Austria joined the European Economic Area in 1994 (and the EU itself in 1995). Even after accession, officials from Austria's central bank and finance ministry attended Lombard Club meetings. An appeal could take two years, during which the banks must put up guarantees to cover their fines.

For Mr Monti, it is a publicity coup. To many Austrians it seems like using a sledgehammer to crack a nut. There are many more anti-competitive banking systems in Europe: the German savings banks, with their grace-period until 2005, and British clearing banks, to name but two. It is also highly political. The Lombard fox was first chased by the far-right party of Jörg Haider and his lawyer, Dieter Böhmdorfer, now minister of justice. Can Mr Haider afford to identify himself with a disciplinary action that enriches his hated EU?

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About sponsorship

Russia's market economy

Time to trade

Jun 13th 2002 | MOSCOW
From The Economist print edition

The European Union and America say Russia is a market economy. Yet membership of the World Trade Organisation is still some way off

Get article background

Another day in the consumer-goods industry

IT WAS a big psychological boost to those in Russia who want their country to be treated as a normal part of the world trading system, rather than as a peculiar post-communist place with special rules at home and abroad. Last week America announced that it now considers Russia to be nothing less than a market economy. Not long before, the European Union had taken a similar step, saying it would change Russia's status by the end of the year. The moves end a period of footdragging that was urged in part by protectionist forces in the West.

On the whole, the endorsements are deserved. Russia's may not be the very model of a modern market economy. It is governed by forces that might politely be described as unusual—including highly politicised subsidies for energy, transport and credit, a welter of organised crime, and arbitrary bureaucratic interference. Still, the laws of supply and demand certainly matter a lot more than they once did. Some bits of the economy, such as a growing software industry, are world-class, although admittedly they are still small.

The practical effect of the new status is limited, however. It may give Russia some protection against anti-dumping measures taken by rich countries. The real prize is membership of the World Trade Organisation, the body that governs global trade. That would put Russia firmly inside a rules-based system, giving it at least some protection against other countries' protection. At home, it would also be a useful rod to beat back a capricious but overweening bureaucracy.

Another round of formal negotiations over accession to the WTO starts in Geneva next week. Russia has made a lot of progress in recent months, chiefly on passing laws that fit WTO standards, and in bilateral talks on particular issues, such as access for manufactured imports. However, the hardest part of the negotiations still lies ahead—in effect, most things involving the bureaucracy, such as sanitary standards (notoriously prone to abuse by officials); the customs system (famously corrupt); and so on. That mirrors the reform process in Russia itself, where legislation has whizzed through parliament, but where anything involving real changes in the way bureaucrats work has been slow or even negligible.

The other big looming snag is likely to be protection of intellectual property. After much huffing and puffing, the United States managed to get Ukraine, another WTO applicant, to close some of its most prominent factories producing pirated compact discs. The plants promptly moved to Russia, where the illegal copying industry has close links to the defence ministry. Counterfeiting of consumer goods remains a big headache, too. Dealing with the rich and powerful criminal gangs that run these businesses will be a formidable job, and also dangerous. So far, there is little sign that the Russian state is up to it.

Even if a deal is struck on these and other issues some time next year, and Russia formally joins the World Trade Organisation in 2004, the real battles will only just be starting. Whatever promises are given during the negotiations about enforcement, the proof of Russia's shift to a true market economy, one based on rules, will be how far they are observed once the deal is done.

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Economics focus

Labours lost

Jun 13th 2002
From The Economist print edition

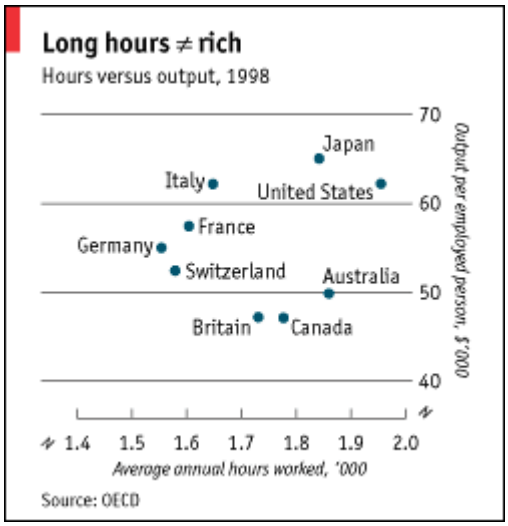
France's 35-hour work-week is fine, so long as it is voluntary

"WORK expands to fill the time available for its completion." Thus Cyril Northcote Parkinson, who first penned the dictum (in *The Economist*) in the 1950s, after his experience in Britain's bureaucracy. Parkinson was more historian than economist, but his first law of work has struck more of a chord with office drones than any formal economic theory. What would he think of a main plank of the outgoing French socialist government's economic policy: its 35-hour work-week?

France's 35-hour law came into effect two years ago, imposing some of the shortest working hours in the world. It requires French companies to pay 39 hours' worth of wages for 35 hours of work. France's workers might now be the envy of the world. Does the French model, though, make for good economics? The answer is no—but it comes with a silver lining.

At the time of its introduction, most economists pronounced the law's motivation—that if each employee works fewer hours, there will be more hours to share around—to be nonsensical. The idea that a fixed quantity of work exists, to be parcelled out among workers, is the so-called lump-of-labour fallacy. France's own Frédéric Bastiat had pointed out two centuries ago that there is no limit to the work that needs doing.

To be sure, there is no iron link between long hours and growing rich (see chart). Americans' puritanical work ethic seems to have been rewarded by a decade of fierce economic growth. On the other hand, for the Japanese, once feared by the rest of the world for their six-day weeks, economic misery has been the reward for the past decade's toil. Britain, according to a recent study by the Economic and Social Research Council, has some of the longest hours in Europe, yet with lower productivity than its neighbours.



So give the French their due: *le trente-cinq* has defied the dire predictions of many economists. French GDP growth averaged 3% per year in 1998-2001, above the average for the euro area. And unemployment did fall sharply after the law was brought in.

Yet the economists were not wrong. Productivity is the crux of arguments in favour of shorter working hours. French employers, proponents say, are now forced to use their workers' time more wisely. French productivity, measured by output per hour, has indeed risen since 2000. Anecdotal evidence suggests that shorter hours at the office are paid for in fewer coffee breaks and smarter work habits. This is the silver lining.

Big manufacturers, such as Renault and Peugeot, have even grown to love the 35-hour work-week, for the greater flexibility they have derived from it. They use it to increase production at tight times, while idling workers during slack periods. Yet smaller firms, says Christel Rendu de Lint of Morgan Stanley, are unlikely to reap similar gains when the new law applies to them in full (it is being phased in gradually). Under political pressure, the new French government may scrap the 35-hour law for them altogether.

Ms Rendu de Lint points to another reason for France's relative success: a decade-long trend towards more temporary and flexible work practices, which has encouraged women to enter the workforce. That

is all to the good. Yet Gilles Saint-Paul, an economist at the University of Toulouse, adds that some of the increase in women's part-time work might be because their husbands' wages are frozen thanks to the 35-hour law. This, he says, hits poorest families hardest.

In sum, the productivity figures may be misleading. Restrictions on hours mean that output per hour is bound to rise, as firms shed lower-value, yet still profitable, tasks. France's output per worker, however, has remained flat. What is more, the government bought big employers' agreement to the law by offering tax breaks. These tax cuts would have helped to bring down unemployment even had there been no 35-hour law.

Under the law, the trade-off between work and leisure is, in effect, made by the French state, with unexpected results. French trade unions, for example, were some of the biggest backers of the 35-hour work-week; now they mostly oppose it. A manual labourer gets less overtime pay and less choice over when to take his time off; while a lawyer working long hours each week gets nine weeks of holidays.

As Parkinson might have predicted, the biggest winners may be state workers. They face no competition and inelastic demand for their services. With a quarter of French workers employed by the state—the largest share in Europe—the 35-hour week may serve merely to increase their ranks, says Mr Saint-Paul, eroding private-sector productivity gains.

Even so, bosses in other countries might take a lesson from France. In some industries, reducing working hours in exchange for flexibility may be a spur to productivity. This is arguably hardest in services, though not impossible: even journalists find that work expands to fill available hours.

Instead of a new law, though, managers and workers might do better to resolve not to waste time. A final thought, courtesy of Mr Parkinson, for those dreaming of a summer holiday: “It is the busiest man who has time to spare.”

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Economics focus

Labours lost

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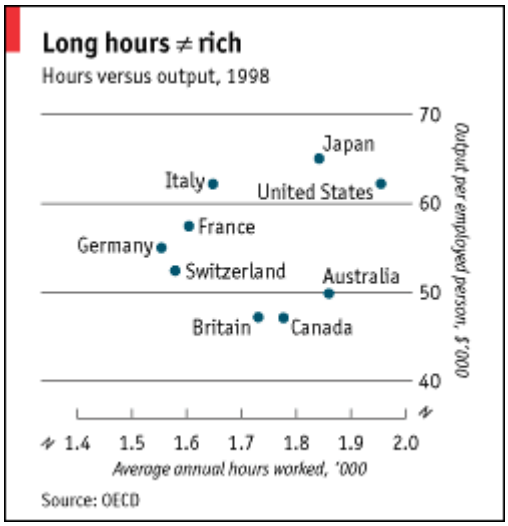

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Orang-utan mates

Let's just be friends

Jun 13th 2002
From The Economist print edition

Female orang-utans like to have male protectors

FOR many women, a tried and tested way of avoiding unwelcome male attention is to introduce a husband or boyfriend—or at least to seek support from a platonic male friend who might appear as such. According to Elizabeth Fox, of Princeton University, orang-utans in Sumatra have cottoned on to the same idea.

Dr Fox's study, soon to be published in *Behavioural Ecology and Sociobiology*, found that potentially fertile female orang-utans consorted with fully grown adult males in order to reduce the risk of sexual harassment (which often results in rape) by smaller sub-adult males.

Orang-utans are relatively solitary, and males and females usually meet only to mate. A pair will remain together until the female gets pregnant, and then she will leave to bring up her young alone. At the Suaq Balimbing Research Station in Sumatra, however, Dr Fox and her team observed a second type of association between males and females. During periods of high fruit abundance, which coincided with an increase in the rate of sexual harassment, females initiated and travelled in “consortships”—temporary non-mating liaisons with familiar adult males.

The researchers found that when females formed such consortships, the success rate that sub-adult males had in raping them was significantly reduced. In 44% of cases of attempted rape, the adult male consort chased the sub-adult away. By contrast, Dr Fox observed that although unaccompanied females did put up resistance, it was usually futile.

Consortship, therefore, helps the female. What the consort gains is less clear. If he is a relative, he might be looking out for his sister or niece in a way that could be explained as kin selection. But perhaps, as in many human platonic relationships, the mere suggestion of something more, satisfied by the female's presence, is all that is required. Who said that opposite sexes cannot be friends?

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Agriculture

Gone to seed

Jun 13th 2002
From The Economist print edition

Seed banks need more of the green stuff

IN TIMES of trouble, people like to deposit their resources in stable banks. This is as true in farming as it is in finance. And these are certainly troublesome times. Many traditional crops, such as ulluco, an edible root that grows high up in the Andes, are losing ground to more commercially viable crops, as farmers plant what the market will buy. Agricultural scientists fear that if this continues, a rich pool of genetic biodiversity may disappear.

One way to safeguard these botanical resources is to place them in special “gene-banks”. Many agricultural plants, such as wheat and rice, can be stored as chilled or frozen seed. Others, such as cassava, which do not reproduce by seed, can be kept as tiny plants in test-tubes. The Food and Agriculture Organisation (FAO) says that there are about 1,300 such repositories around the world, ranging from a depot of almost 10,000 samples of lentils kept in Syria to a store of 1,200 varieties of banana held in Belgium. In total, these stocks add up to roughly 6m samples of plants.

Many of these seed banks are facing hard times, particularly in developing countries. Collecting and cataloguing hundreds of thousands of samples costs money. Phil Pardey, an agricultural economist at the University of Minnesota, estimates that maintaining a sample in a gene-bank for a year costs between $1.50 and $12, depending on the location and the type of plant conserved. Just keeping the lights on and the refrigeration running can be a challenge: the national gene-bank in Kenya almost lost its collection when it could not afford to pay its electricity bill.

Such brushes with disaster have spurred agricultural scientists into action. The FAO and the Consultative Group on International Agricultural Research—an international network of public research centres that holds roughly 10% of the world's plant deposits—are trying to raise an endowment of $260m to maintain the world's most important collections in perpetuity. They also hope to provide resources to conserve thousands of varieties that have yet to make it to safe havens. The consortium is now in talks with governments, non-governmental organisations and private companies. It hopes to raise $80m by the end of the year.

According to Geoffrey Hawtin, head of the International Plant Genetics Resources Institute in Rome, gene-banks have more than museum value. Seeds and plant parts contain genes that can be bred into commonly used varieties in order to boost yields, increase disease resistance or improve nutritional content. Those in the field are keen to use such resources. Between 1995 and 1999, for example, the consortium shipped roughly 88,000 samples a year to researchers, breeders and farmers. With more funding, it will be easier to turn yesterday's wallflowers into tomorrow's crops of choice.

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Human genetics

deCODED?

Jun 13th 2002
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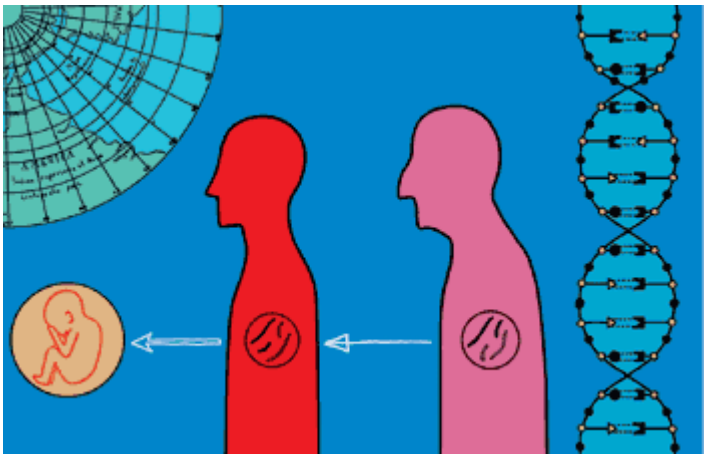

A new map of the human genome should help both doctors and biologists

Get article background

AMID the brouhaha surrounding the Human Genome Project and its commercial rivals, the fact that there is more than one way to map a genome has got rather lost. Physical mapping, as the Human Genome Project approach is known, relies on chopping genetic material into pieces, and working out the order of the nucleotide bases (the chemical “letters” in which the genetic message is spelled out) of each piece. Computers then fit the sequences of the separate pieces back together by finding overlaps between them and, presto!, the sequence can be read.

Physical maps tell you a lot. But they cannot tell you everything. It is hard, for instance, to use them to find associations between particular versions of genes (alleles, in the jargon) and the diseases that those alleles might cause. For that, a second type of genetic cartography is better—so-called linkage mapping.

Linkage mapping has been somewhat neglected in recent years. The best available map was created in 1998 (a lifetime ago, in modern genetic science) by the Marshfield Medical Research Foundation, in Wisconsin, based on data collected in France. But a new one has just been published by deCODE, an Icelandic firm, in *Nature Genetics*. Besides being at higher resolution than the Marshfield map, it reveals some intriguing facts about human reproduction. It also reveals the whereabouts of what the company hopes might prove to be very lucrative genes.

A linkage map follows genes through the generations. Each chromosome in an individual is a chimera of the corresponding chromosomes in one of his or her parents. Most body cells have 46 chromosomes, organised in 23 pairs. When the sex cells (eggs and sperm) are forming, the individual members of these pairs come together and swap sections, in a process called crossing over. Cell division then separates the newly mixed “daughter” chromosomes into two sets of 23. Sex cells thus have half the normal chromosomal complement. This means that, when they unite, the full complement is restored.

Mapping Iceland

The map attempts to link features of the genome together, based on how frequently they are separated by crossing over. The features most easily traced are known as microsatellites. These are sections of a chromosome in which two or three nucleotides are repeated over and over again. The locations of these

repeating sections are predictable, but the number of times a group of nucleotides is repeated varies from chromosome to chromosome. That allows microsatellites (and so any genes that are near them) to be tracked from parent to offspring.

For this to work, though, you have to know who has mated with whom, ideally over several generations. And that (besides the nationality of the firm's founder, Kari Stefansson) is the reason deCODE is based in Iceland. The intense interest of that country's inhabitants in their genealogies, and the fact that they are descended from a small group of founders, means that conditions for linkage mapping are particularly propitious. And combining the result with Iceland's excellent medical records, which stretch back the best part of a century, means that the map can be used to identify disease genes as they pass from one generation to another.

The company's computers do this by searching for correlations between the presence of particular microsatellites in individuals and the appearance of particular diseases in those individuals. Then, using gene-location data from the Human Genome Project, they can see which nearby genes are likely, if they malfunction, to lead to the disease. Lastly, they can check to see if the individuals involved share an abnormal variant of that gene.

On this front, deCODE has done well. It is on the trail of around 40 previously unsuspected genes (or, rather, versions of genes) that are implicated in illnesses of varying seriousness, from allergies to Alzheimer's disease. Three—for schizophrenia, strokes and a circulatory illness known as peripheral arterial occlusive disease—have been specifically identified.

Some less practically applicable biology has come out of deCODE's mapping effort, too. Linkage maps ruthlessly expose cuckoldry, and if genealogies are available, they can do so among generations long past, as well as those alive today. Icelanders seem, both now and in the past, to be encouragingly faithful partners. Only about 1% of them have been fathered by a man other than the one who thought he was responsible, and thus registered the birth. (The limited data available for Britain, by contrast, suggest such misconceptions attend 5-10% of births.)

The mapping effort has also confirmed that the process of crossing over varies between the sexes. First, the rate of crossing over is quite variable in women, but not in men, though nobody knows why. Second, some of the places along the chromosome at which crossing over happens most frequently differ between the sexes.

Mapping the world

The idea that there are, in both sexes, “preferred” places for chromosomes to break and exchange material also underlies the conclusions of another paper, by David Altshuler, of the Whitehead Centre for Genome Research, in Cambridge, Massachusetts, and his colleagues, published last month in *Science.* This suggested that chromosomes are composed of small blocks that get shuffled by crossing over, but are, themselves, rarely broken up.

The markers used by Dr Altshuler were not microsatellites but single-nucleotide polymorphisms (SNPs). These are places where chromosomes vary by a single nucleotide. SNPs are observed, on average, once every few hundred nucleotides. They therefore provide finer detail than do microsatellites, which occur less often.

Dr Altshuler and his colleagues looked at a relatively small part of the genome—51 regions scattered across different chromosomes, adding up to about 0.4% of the total. However, they studied people from three continents: Africa, Asia and Europe. They found that sets of adjacent SNPs frequently stick together. Indeed, they were able to identify 928 such SNP-blocks, many of which had not been broken up by crossing over since the emergence of *Homo sapiens* 100,000-200,000 years ago. Some had a restricted distribution. Others occurred across all three continents. In particular, the SNP-blocks in Europeans and Asians were similar, and both were sub-sets of the more diverse African pattern.

That observation lends support to the “out of Africa” theory of human origin. This is that *Homo sapiens* evolved in Africa, and that most non-African populations trace their origins to that continent. That is good news for evolutionary biologists. Dr Altshuler's result is good news for disease hunters, too, since a map of SNP-blocks would simplify the process of locating malevolent alleles. Once linkage mapping has determined the area in which a disease gene resides, tracking SNPs is already used to help locate the exact culprit. Knowing how SNPs associate with one another should speed that process up.

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New fiction

Visible man

Jun 13th 2002
From The Economist print edition

Part thriller, part campus novel, part satire, a new novel is the talk of America

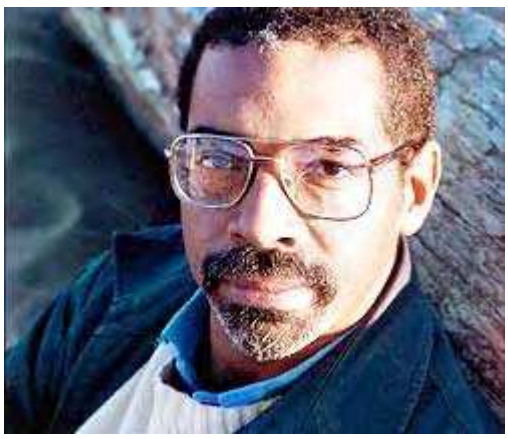
The Emperor of Ocean Park
By Stephen L. Carter

Knopf; 657 pages; $26.95.
Jonathan Cape; £18

Buy it at
Amazon.com
Amazon.co.uk

WHEN Alfred Knopf paid a reported $4.2m for this thriller in a two-book deal, the publishing house gambled recklessly. The author, a professor of law at Yale, had written seven non-fiction books, including “The Dissent of the Governed”, “God's Name in Vain” and “The Culture of Disbelief”, but not a single word of publishable fiction. He was not even a particularly gifted writer. His non-fiction indicated, and “The Emperor of Ocean Park” now confirms, that his prose is competent rather than inspired.

But if enjoyment is the test, Stephen Carter earns his advance. He not merely holds your attention, he stimulates it for all 657 pages, though not for the expected reasons. This is a thriller without thrills. Its storyline is even more convoluted than the plots of John Le Carré's spy stories, and it is riddled with preposterous whodunit machinations involving a box secretly buried at night in a graveyard, a message hidden in a child's toy and clues embedded in chess stratagems. It is, frankly, hard to give a fig whether the hero-narrator, Talcott Garland, or his murderous rivals first solve the central mystery: the meaning of a death note left by Garland's father, a judge of rancid conservative views who dies in menacing circumstances sometime after a public scandal puts paid to his nomination to the Supreme Court.



The novel's humour obliterates these faults. Much of the action takes place on campus, and Mr Carter is as witty as David Lodge about academic vendettas, and more venomous. His scholars ooze goodwill as they scheme to ruin their colleagues' careers, reputations and marriages. In a key incident, anonymous accusers expose a scholar in line for a coveted judicial post as a plagiarist.

There is a serious theme, too. The novel's narrator belongs, like its author, to the black upper-middle class. From this viewpoint, “The Emperor of Ocean Park” provides an unusual take on the enduring power of racial prejudice and racial stereotyping in the United States. Old-money African-Americans rarely write or appear as characters in fiction and, if this book is any guide, these affluent members of “the darker nation” feel not so much ignored as made invisible by “the paler nation”.

Mr Carter's denials that the book is in large part autobiographical fly in the face of the fictionalised facts. Consider the evidence. Talcott Garland, is a middle-aged, church-going, socially-conservative African-American, as is Mr Carter. He is, again like Mr Carter, a professor of law. The Ivy League university where Garland teaches resembles Yale. The town he lives in, Elm Harbour, could easily be New Haven. In short, Garland-Carter is part of the black American elite. His family and friends live in such urban enclaves as the Gold Coast neighbourhood in north-west Washington, DC. They own holiday homes on Martha's Vineyard. And, despite their success, they are racked by guilt and intense feelings of conflict.

Watching ambitious black law students sucking up to a managing director of Goldman Sachs, a Wall Street investment bank, Garland suddenly understands “the passion of the many black nationalists of the 1960s who opposed affirmative action” in the belief that it would “strip the community of the best among

its potential leaders", send them off to the best colleges, and "turn them into...well, into young corporate apparatchiks in Brooks Brothers suits, desperate for the favour of powerful white capitalists...fancy college degrees and fancier money for the few would supplant justice for the many."

White liberals should withhold their applause. They are presented throughout as bossy people far more comfortable telling blacks what they need than asking them what they want. Teachers at expensive private schools are particular objects of scorn. Those at the pre-school Garland's son attends encourage hugging between boys (little boys hugging little girls would, of course, be inappropriate behaviour). It is done "in the service of some unarticulated ideological goal—making sure they don't grow up to be the kind of men who drop bombs on innocent civilians, perhaps. But I am not sure why the teachers bother." It goes on that these kids "are far more likely to grow up to be the kind of men who sit in the White House ordering others to drop the bombs, in between hugging their constituents."

Just about everybody will be offended by something or other in "The Emperor of Ocean Park". But the book will also make its readers think and laugh. Only the promised thrills are missing. Maybe Mr Carter will provide them in the second part of his $4.2m deal.

The Emperor of Ocean Park.
By Stephen L. Carter.
Knopf; 657 pages; $26.95.
Jonathan Cape; £18

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About sponsorship

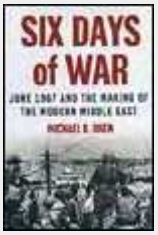
Arabs and Israelis

It needn't have happened

Jun 13th 2002
From The Economist print edition

WARS don't really break out by accident, do they? In June 1967, one did. The strength of Michael Oren's meticulous new history lies less in his account of the six-day war than in his analysis of the crisis that preceded it. With India and Pakistan in a hair-trigger confrontation over Kashmir, the sequence of miscalculations that propelled the Middle East into war 35 years ago looks newly relevant.

Six Days of War: June 1967 and the Making of the Modern Middle East
By Michael B. Oren



Oxford University Press; 446 pages; $30 and £25

Buy it at
Amazon.com
Amazon.co.uk

Mr Oren argues that neither Israel nor Egypt wanted war. So what caused it? First, of course, was the existence of an unresolved political conflict. In the late 1960s, the Arab states still deemed Israel's creation illegitimate and demanded its reversal. All-out war seemed improbable, but low-level violence was omnipresent. Cross-border Palestinian raids, many by Yasser Arafat's new Fatah organisation, prompted ever-harsher Israeli reprisals. There were artillery and—in April 1967—air skirmishes between Israel and a fiery Baathist regime in Syria. All the same, Egypt's president, Gamal Abdel Nasser, did not believe that the Arabs were ready for war. And Israel's prime minister, Levi Eshkol, was determined to prevent tension with Syria sparking a wider conflict.

A second destabilising factor, however, was the cold war. The coup-threatened Syrian regime saw its hard line against the “Zionist entity” as a way to shore up its own credibility. And the Soviet Union, though wary of starting a war that the Arabs might not win, nonetheless saw cold-war advantage to be gained by keeping regional tensions on a low boil. In April 1967, for reasons that Mr Oren still finds mysterious, the Soviets warned the Egyptians, erroneously, that Israel was massing its army for an invasion of Syria. Fatefully, Nasser took the Soviet warning seriously.

Nasser was aware of his army's shortcomings. But—and to Mr Oren's mind this was a third factor that precipitated war—his caution was not shared by Field-Marshal Abdel Hakim Amer, the head of the armed forces, with whom Nasser shared a complex and rivalrous friendship. Under pressure from Amer, with tension high on the Israel-Syria border, and after the Soviet warning, Nasser could not do nothing. So he decided, initially as a mere gesture, to send his forces ostentatiously into the Sinai peninsula. When he discovered that Israeli troops were not after all massing against Syria, it was too late, without a climb-down, to call them back.

By now, the crisis fed on itself. Egypt's fire-breathing move into Sinai thrilled Arab opinion everywhere. Lionised by the masses, feeling himself on a roll, Nasser followed up by demanding, as was his right, the withdrawal of the UN forces deployed on his border with Israel. He then closed the Strait of Tiran to Israeli shipping. “The Jews threaten war,” he roared. “We tell them: you are welcome, we are ready.”

These manoeuvres created confusion in Israel. Though Eshkol had mobilised much of Israel's army, his initial assessment was that Nasser was seeking prestige rather than war. But the closure of the strait shook his confidence. And Eshkol's reluctance to respond was soon seen in Israel as a problem in itself. Israel's generals were now advising the prime minister that showing such weakness would fatally compromise the nation's deterrence.

A final destabilising factor was the inadequate response of the great powers. The Americans did not give Israel the reassurance it sought. President Johnson called for Egypt to lift its blockade of what America considered an international waterway. In private, he made his partiality to Israel plain. But Johnson did not provide Israel with a non-military way out of the crisis. The Pentagon grumbled about a proposal to send an international armada through the blocked strait, and congressmen feared America being drawn

into a second Vietnam. Israel, Johnson told its foreign minister, “will not be alone unless it decides to go it alone.” But if Israel did not go it alone, who else would sever the noose it felt tightening around its neck?

The fear of fighting alone

So one-sided was Israel's victory when Eshkol did at last decide to strike that it is hard now to recall how vulnerable the Jewish state looked and felt in the waiting period before the war. As Egypt, Jordan, Syria and Iraq made a great show of co-ordinating war plans, Eshkol was terrified of fighting alone, without the support of any great power. The army was confident that it could win if it struck first, but Yitzhak Rabin, the chief of staff, suffered a nervous collapse on the eve of battle. In the end, a beleaguered Eshkol chose war because he felt he had run out of alternatives.

The Americans thought he had, too. Mr Oren cites an eve-of-war note by Dean Rusk, the secretary of state, concluding that the “holy-war psychology” of the Arab world had collided with the “apocalyptic psychology” of an Israel that feared for its very survival. The six-day war changed the Middle East. But it did not change the psychology.

Six Days of War: June 1967 and the Making of the Modern Middle East.
By Michael B. Oren.
Oxford University Press; 446 pages; $30 and £25

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About sponsorship

Civilian leadership in war

When not to listen to your generals

Jun 13th 2002
From The Economist print edition

ON ANY weekday morning in Belgrade, weary pedestrians and rusty, smoke-belching cars inch their way to work across the broad Sava river which divides the city. It must be a galling picture for the American air chiefs who wanted to destroy all of Belgrade's bridges early on in the air war against Serbia in 1999: it was squeamish politicians—and what's worse, European politicians—who held them back from inflicting the full-scale damage on Serbia's economy and society they so urgently recommended.

For those who believe that the armed forces should be allowed to get on with the job once the decision has been made to go to war, a happier precedent was set by President Bush senior at the outset of the Gulf war of 1991. In his own words, he was determined not to "micro-manage the military" or "repeat the problems of the Vietnam war, where the political leadership meddled with military operations".

In reality, there is no clear dividing line between the job of politicians who proclaim a war's aims and the soldiers who work out how to achieve them. The wars countries declare are seldom the wars they end up with. Victory conditions tend to change as conflict drags on, and politicians as well as generals play their part in that inevitable business of revision. Nor is the selection of weaponry, tactics or points of attack ever a purely technical issue; almost any choice has moral and strategic consequences, both direct and indirect, which professional soldiers cannot always see as clearly as their masters can.

Supreme Command: Soldiers, Statesmen and Leadership in Wartime
By Eliot A. Cohen

The Free Press; 304 pages; $25

Buy it at
Amazon.com
Amazon.co.uk

Demolishing a myth

So it is well worth devoting some energy to stamping on the myth that soldiers should be allowed to go about their business without pesky politicians getting in the way; and an important contribution to this demolition job has been made by Eliot Cohen, a professor of strategic studies whose students include naval cadets as well as political scientists. As he demonstrates, it is not necessary to be a dove or an anti-militarist to believe that, in some circumstances, it is appropriate and vital for politicians to immerse themselves in the details of military affairs.

He makes this case by offering pen-portraits of four charismatic war leaders who were not career soldiers themselves but nonetheless refused to be blinded by military science or fobbed off by senior officers who insisted that they knew best.

Abraham Lincoln, he shows, was a shrewd, almost devious manager of human talent who was able to deploy his generals in ways that played to their strengths and neutralised their weaknesses. Thanks to rail transport and telegraphy, it was possible for him to oversee the war on a day-to-day basis without leaving Washington. The technology which allowed President Bush to sit in the White House watching Predator drones swooping over Afghanistan has its roots in the Lincoln era.

Georges Clémenceau was a progressive, anti-clerical politician who distrusted the conservatism and anti-Semitism of France's senior brass. But when he came to power in November 1917, after a million or so of his compatriots had died in battle, his distance from the old guard was a distinct advantage. He was able to inspire, and be inspired by, more junior soldiers during his frequent visits to the front.

Winston Churchill, a figure from the heart of the establishment who despised establishment thinking, was

always prepared to lend an ear to mavericks, eccentrics and out-of-the-box thinkers, as a counterweight to his immediate military advisers for whom he had a healthy disrespect. “I have to wage modern war with ancient weapons,” was one of his famously caustic observations, as he watched his chiefs of staff file out of a meeting.

David Ben-Gurion, sensing that Israel's foundation would require a switch from guerrilla tactics to inter-state warfare, suspended all his other duties in May 1947 and spent two months in intense discussion with the officers of his fighting force, the Haganah—only to realise they were even worse prepared than he thought.

Mr Cohen does not quite convince the reader that his four heroes—so different in age, culture and circumstance—had anything very specific in common. But all of them had to make bold and controversial decisions which were certain to provoke bewilderment and horror at the time.

Among these were Churchill's ruthless assault on the French fleet at Oran in 1940, shortly after France's surrender; and Ben-Gurion's attack on the *Altalena*, a ship bringing arms to a rival Jewish group, the Irgun—which had the desired result of forcing that group to merge with the incipient Israeli Defence Force.

What Mr Cohen's thumbnail sketches also confirm is that leaders at one remove from the military establishment are often quicker than generals at sensing when a historic sea-change has occurred, rendering useless all the conventional wisdom (including military wisdom) of years past. Churchill, for example, was among the first to see how nuclear arms would change every strategic assumption.

Supreme Command: Soldiers, Statesmen and Leadership in Wartime.
By Eliot A. Cohen.
The Free Press; 304 pages; $25

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About sponsorship

Scientific lives

Account paid

Jun 13th 2002
From The Economist print edition

SHE was the crystallographer at King's College London whose immaculate X-ray pictures helped Francis Crick and James Watson in Cambridge divine the structure of DNA in 1953. They had seen Rosalind Franklin's findings without her knowing. Notoriously, she won little of the glory.

In his 1968 bestseller, “The Double Helix”, Watson wrote of a bad-tempered, bluestocking “Rosy”, who “might have been quite stunning had she taken even a mild interest in clothes”. His caricature was all the crueller because, alone among the main players, she was no longer alive to reply: she had died of ovarian cancer at the age of 37.

Posthumously, Franklin was adopted as a feminist icon. She was the unacknowledged heroine of DNA, the Sylvia Plath of molecular biology. But there was no rounded account of her life. Brenda Maddox's meticulous biography fills that gap.

Rosalind Franklin: The Dark Lady of DNA
By Brenda Maddox

HarperCollins; 380 pages; £20

Buy it at
Amazon.co.uk

Leading up to the DNA work at King's was a comfortable Anglo-Jewish girlhood; St Paul's Girls' School and Newnham College, Cambridge (when women were awarded only “decrees titular”; a doctorate on the structure of coal, and three happy years in Paris on X-ray crystallography. After King's came productive work on viruses.

Franklin did not have to oppose her father, as some say, in going to university and pursuing science. Nor was King's notably hostile to women. Her unhappiness there was due largely to a strained professional relationship with Maurice Wilkins, the third of the three DNA Nobel laureates. Complex, combative and serious, Franklin could certainly be difficult, but she was capable also of team play, and inspiring others. She had many friends and loved travel.

Her work was crucial to Messrs Crick, Watson and their Nobel prize, as they belatedly admitted. Her notebooks show how close she was to the solution herself. This lively account raises the possibility of romance, but the evidence is simply too slim. What shines through is Franklin's passion for research: “Science, for me,” she wrote to her father from Cambridge, “gives a partial explanation of life.”

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HarperCollins; 380 pages; £20

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About sponsorship

Shakespeare's language

Fardels by any other name

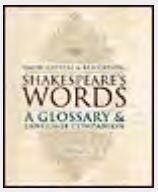
Jun 13th 2002
From The Economist print edition

Would the Bard be better in modern English? 'Od's pittikins, no

ALTHOUGH welcome as a magnificent tool, this doorstop compendium prompts an alarming question: has Shakespeare become a foreign language to us? Are non-English-speakers, as some Shakespeare scholars have suggested, more at home with their translated Shakespeare than English-speakers with their genuine article? It's not so much the hard words, such as “fardel” or “grise” or “orgulous”. The context will explain these, as it does whole passages: “Proclaim no shame,” says Hamlet in disgust at Gertrude, “When the compulsive ardure gives the charge,/ Since frost itself as actively doth burn,/ And reason panders will.” Don't try—you get the drift.

More insidious are the places that seem safe. When Hamlet asks Ophelia if she is “honest”, and two lines later if she is “fair”, do we feel the sexual sting? The word “sex” and its derivatives were not used in our sense then. Shades of meaning in honesty, affection, fancy, sense or blood, did the business. Lucky foreigners, it is said, who can render the connotations—and sweep away the inauthentic air of archaism.

Shakespeare's Words: A Glossary & Language Companion
By David Crystal and Ben Crystal



Penguin; 650 pages; £20. To be published in the United States by Penguin Putnam in November

Buy it at
Amazon.co.uk

David and Ben Crystal, father-and-son editors, are aware of the unwanted message carried by the very existence of their book. Their introduction assures us that Shakespeare's obscurity is overstated, that “it is perfectly possible to go to a Shakespeare play, with little or no awareness of Early Modern English vocabulary, and have a great time.” All the same, they can't help admitting that if you know more, you'll have a greater time.

Shakespeare glossaries have appeared before: one in 1874, by a German philologist, Alexander Schmidt, and another in 1911, compiled by one of the “Oxford English Dictionary” editors, C.T. Onions. Since then, editors, critics and stage directors have busied themselves elucidating his texts and altering our understanding of them. Thanks to Freud, interest in ambiguity and hidden meaning have become commonplace; English usage itself has changed. So have assumptions: the classics are no longer generally taught; Shakespeare's audiences and readership are global; little can be taken for granted about common fields of reference or education.

The editors have thought of all this, of the ordinary punter as well as the student and scholar, and have produced a huge work of user-friendly scholarship. Appendices explain Shakespeare's references to classical mythology, the Bible, folklore and history. They map out the *dramatis personae* for each play. They list and define the feasts of the Christian calendar; they explain Shakespeare's London, and places beyond. They translate his French for you, his Latin and Welsh dialect.

As for the English words themselves, the editors ease inexperienced readers quickly past the first stumbling blocks, by gathering up 100 frequently met words into an introductory section: words like

“beshrew”, “fain”, “haply”, “methinks”, but also false friends like “become” (be fitting), “habit” (clothing), “owe” (own), “sad” (serious), “undone” (ruined). They then extend the idea into the A-to-Z section with panels of words associated with particular subjects (eg, weapons, money, plants), situations (eg, politeness, swearing, farewells) and grammatical or linguistic forms (eg, archaisms, “thou” and “you”). It works brilliantly, providing coherent corners of Shakespeare's language within the alphabetical list.

The list itself is heroic. Here are 21,263 entries, we are told, with quotations illustrating each word and its uses, accompanied by further line-references. If in doubt about an inclusion or a distinction, the editors have gone for more, not less. Take a simple word like “bury”, for example. Where Onions groups together its two figurative meanings—“abandon” and “conceal” (as in “burying differences” and in “burying the evidence”)—the Crystals enter each separately, give three varying synonyms apiece, and five references all told. A richer word, such as “invention”, expands from Onions's three neat categories, to eight. Users will have the odd grumble about excesses and glosses (surely Sonnet 98's “heavy Saturn” is the gloomy planet, not the Roman harvest god) but the aim is laudable: to highlight the range and multiplicity of meanings and so strengthen the reader's intuition for the language.

It is sometimes assumed that it is only a question of time before Shakespeare becomes inaccessible. But does time come into it? As early as 1679, John Dryden was complaining that “the tongue is so much refined since Shakespeare's time that many of his words are scarce intelligible, and his whole style is so pestered with figurative expressions that it is as affected as it is obscure.” Shakespeare's 17th- and 18th-century adaptors blithely clarified him. In 1664, when William Davenant adapted “Macbeth”, the hero was made to say that his bloody hands would “add a tincture to/The sea.” Not until 1744 when Garrick, in part, restored the original, was Shakespeare's “multitudinous seas incarnadine” heard again on stage. In fact, time may have helped. Modernism has made us more patient with obscurity. We rate suggestion more than clarity. When, for example, the horrified Claudio in “Measure for Measure” imagines himself dead and lying “in cold obstruction”, we relish the strange blockish mouthful before turning to the notes.

It startled them as well

Leafing through this glossary, you are reminded that the written language of Shakespeare's day was often on the edge of outlandishness, even then. The editors devote a panel to the practice of converting parts of speech (nouns for verbs, adverbs and adjectives for nouns, etc): eg Antony's “spanielled me at heels”; Prospero's “dark backward and abysm of time”. In smaller ways, unfixed forms abound: was it “irregular” or “irregulous”, “iterance” or “iteration”, “intrinse” (for “intricate”) or “intrinsicate”, “unkind” or “kindless”, “indurate” or “obdurate”? Latin imports jostle the Anglo-Saxon: “evitate”, for example, glossed in the same line by “shun”. Dryden may have frowned, but out of this lexical unruliness (genius aside) come inspired strokes, such as Hamlet's “windy suspiration of forc'd breath”—which, as Frank Kermode has pointed out, means strictly “breathy breathing of forced breathing”.

Of course there's an argument for clarity; but accessible Shakespeare in modern translation may bury as much as 16th-century Shakespeare does. So, when foxed and flummoxed, there's nothing for it but this excellent glossary. A question for readers: does “knowing your onions” refer to C.T.? If so, the modern gloss will have to be “knowing your Crystals”.

Shakespeare's Words: A Glossary & Language Companion.
By David Crystal and Ben Crystal.
Penguin; 650 pages; £20. To be published in the United States by Penguin Putnam in November

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About sponsorship

Lew Wasserman

Jun 13th 2002
From The Economist print edition

Lew Wasserman, a Hollywood mogul, died on June 3rd, aged 89

IT WAS a matter of pride for Lew Wasserman that he did not stab people in the back. It was simpler to stab them in the front. In her autobiography Shirley Temple recalled when she was dumped by Mr Wasserman.

“Why?” I yelped.

“Because you're through.” His eyes were unwavering, inky black. “Washed up.”

When the once “little curly top” started to cry, Mr Wasserman handed her a tissue. “Have one on me,” he said.

Miss Temple had got off lightly. Mr Wasserman could be much nastier. “The godfather” was the slightly sinister noun that cropped up in the mixed obsequies that have followed his death. What upset Miss Temple professionally was that she had been sacked by her agent. Stars dropped agents, she said, not the other way round. But by now, the 1950s, Lew Wasserman was more than just another theatrical agent. He was head of the Music Corporation of America, the MCA, which was daily becoming more powerful and was to dominate Hollywood for the next 30 years.

The actors, directors and writers who made Hollywood the world's greatest assembly of creative talent would often feel humbled that their work was controlled by a salesman. Nor had Mr Wasserman the humanising features that made other Hollywood moguls such as Sam Goldwyn (“Never make forecasts, especially about the future”) so endearing. But the changes he brought about made the Hollywood factory more productive and the stars, those that survived, immensely rich. Mr Wasserman and the MCA did all right too.

He persuaded the stars to break their contracts with studios and sign up with him. New contracts were made with studios for more money. Mr Wasserman pioneered packaging: the actors, directors and writers for a whole production would be leased as a group to a studio. Not only would the studios pay salaries, but they would have to share the profit on the film with MCA and its clients. Turning the screw, MCA sometimes included in the deal less well-known actors that it wanted to push. Ronald Reagan, rated a “B” actor, benefited from Mr Wasserman's zeal, and remained a close friend during his long climb to the United States presidency.

Men in dark suits

Lew Wasserman, the son of emigrants from Russia, started in the entertainment business at the age of 17 showing customers to their seats in a Cleveland cinema. In those days cinemas had live acts as well as films. Mr Wasserman remembered meeting Eddie Cantor, a big name at the time. More important, he got a job with the Music Corporation of America. Despite its important-sounding name, the Chicago-based MCA was then a relatively small agency. But Lew Wasserman saw his chance. He put in long hours to build up the business. In 1938 he moved to Hollywood. In 1946 at the age of 33 he was the boss of MCA. He and his staff dressed conservatively in dark suits and white shirts. They were businessmen. The day of the agent as a “flesh peddler” in a coloured shirt was over, he said.

As his power grew, Lew Wasserman found himself courted by politicians. In the hunt for votes, there was always room for a film star on your platform, and Mr Wasserman provided the best. With his powerful connections he could raise millions of dollars with a few phone calls, whether the money was for a politically important good cause, or simply for a political campaign. The politicians honoured the debt. Our picture is of Ronald Reagan showing Mr Wasserman around the White House. Lyndon Johnson offered him a job in his cabinet as secretary of commerce, but was not surprised when he turned it down. Bill Clinton awarded him the Presidential Medal of Freedom, the country's highest civilian honour.

In his constant quest for new business Mr Wasserman expanded into television, radio and records and bought film studios. He became known as “the octopus”. The government became concerned about the octopus's growing monopoly of entertainment and in 1962 threatened the MCA with antitrust proceedings. To appease the government, Mr Wasserman gave up the talent agency, which by then was only a minor source of MCA's profits, and concentrated on its other interests, particularly film production.

If anything is remembered of his contribution to the history of Hollywood, it may be the films that MCA was midwife to such as “Jaws”, “Star Wars” and “E.T.”, fantasies for the masses that went down as smoothly as fast food. But unlike Goldwyn and other moguls he never put his name on a film; rarely read a script. He did the arithmetic. If there was a guaranteed profit, the project was on.

In 1990, when MCA began to slip in competition with new entertainment groups, Mr Wasserman sold the company to Matsushita, a Japanese electronics company, for $6.6 billion. Matsushita got him to stay on as chief executive but it became tired of the financial drain and in 1995 secretly sold most of the business to Seagram, a Canadian liquor company. Mr Wasserman learnt of the deal in the newspapers. He was scornful. If you are going to stab, stab openly.

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Overview

Jun 13th 2002
From The Economist print edition

New optimism for the **euro area**: the ZEW research institute's expectations indicator rose briskly by 4.1 points to 72.5 in June. For **Germany** alone, the expectations index rose to 69.6, up by 3.3 from 66.3 in May.

In the year to May, consumer prices rose by 3.3% in the **Netherlands** and by 1.4% in **France**.

European shares slipped. France's CAC 40 and Britain's FTSE 100 hit eight-month lows.

Finland's economy has been hit hard by the global economic downturn, and especially by slumping demand for electronics and forest products. GDP fell by 2.0% in the year to the first quarter, a long way short of its spectacular 5.6% growth in 2000.

American workers received a pay rise of 3.2% in the year to May, down from 4.2% a year earlier; the increase is equivalent to a 1.6% rise in real terms.

Japan may have emerged from its worst recession since the second world war. GDP rose at an annual rate of 5.7% in the first quarter, though it is still down by 1.6% on a year ago. Despite this, a rising yen is still a threat to Japanese exports. Deflation in producer prices continued, with prices falling by 0.9% over the year to May.

The **euro** rose to a 17-month high against the **dollar**, hitting $0.95.

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Output, demand and jobs

Jun 13th 2002
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 3.6	+ 4.2 Q1	+ 4.0	+ 3.9	+ 2.5 Q4	+ 5.0 Q1	6.3 May	6.8
Austria	– 0.7	– 0.4 Q4	+ 1.3	+ 2.7	– 3.1 Mar	+ 1.0 Feb	4.0 Apr	3.4
Belgium	+ 2.0	– 0.3 Q1	+ 1.4	+ 3.1	–10.8 Mar	– 2.5 Mar	10.4 May*	10.0
Britain	nil	+ 1.0 Q1	+ 1.8	+ 3.0	– 4.1 Apr	+ 6.9 Apr	5.1 Mar†	5.1
Canada	+ 6.0	+ 2.1 Q1	+ 2.9	+ 3.6	– 0.6 Mar	+ 5.4 Mar	7.7 May	7.0
Denmark	+ 1.4	+ 1.1 Q1	+ 1.6	+ 2.5	– 0.8 Apr	+ 2.1 Feb	5.0 Apr	5.4
France	+ 1.4	+ 0.3 Q1	+ 1.4	+ 2.9	+ 0.9 May	– 0.6 Apr	9.1 Apr	8.6
Germany	+ 0.7	– 1.2 Q1	+ 0.9	+ 2.7	– 2.0 Apr	– 1.9 Apr	9.7 May‡	9.2
Italy	+ 0.6	+ 0.1 Q1	+ 1.3	+ 2.9	– 7.6 Mar	+ 0.5 Mar	9.0 Jan	9.8
Japan	+ 5.7	– 1.6 Q1	– 0.8	+ 1.2	– 6.1 Apr	– 2.7 Apr	5.2 Apr	4.8
Netherlands	nil	nil Q1	+ 1.4	+ 2.9	– 5.6 Apr	– 0.2 Mar	2.2 Apr§	2.0
Spain	+ 2.1	+ 2.0 Q1	+ 2.2	+ 3.3	+10.0 Apr	na	11.3 Apr**	10.6
Sweden	+ 1.1	+ 1.1 Q1	+ 1.8	+ 3.0	+ 1.6 Mar	+ 4.7 Apr	3.8 Apr*	3.7
Switzerland	+ 0.7	+ 0.2 Q1	+ 1.1	+ 2.3	– 1.0 Q4	+ 4.3 Apr	2.5 May*	1.7
United States	+ 5.6	+ 1.5 Q1	+ 2.9	+ 3.5	– 2.0 Apr	+ 5.7 Apr	5.8 May	4.4
Euro area	+ 0.9	+ 0.1 Q1	+ 1.3	+ 2.9	– 2.9 Mar	+ 2.0 Mar	8.3 Apr**	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 0.6	– 2.0 Q1	na	na	+ 6.8 Apr	+ 1.9 Feb	10.4 Apr*	10.3
Greece	na	+ 4.3 Q1	na	na	– 2.0 Feb	+ 8.4 Jan	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.6 Apr*	1.6
Ireland	na	nil Q4	na	na	– 2.7 Apr	+ 0.1 Mar	4.2 May	3.7
Luxembourg	na	+ 3.52001	na	na	– 7.1 Mar	+15.3 Jan	2.8 Mar	2.6
New Zealand	+ 2.6	+ 2.9 Q4	na	na	+ 3.5 Q4	+ 8.2 Q1	5.3 Q1	5.4
Norway	+ 1.0	+ 1.8 Q4	na	na	+ 3.9 Apr	+ 3.9 Apr	4.1 Q1	3.7
Portugal	+ 1.8	+ 1.0 Q4	na	na	+ 1.0 Apr	– 0.2 Apr	4.4 Q1*	4.2

*Not seasonally adjusted. †Jan-Mar; claimant count rate 3.2% in Apr. ‡EU harmonised rate 8.1% in Apr. §Feb-Apr. **Revised series.

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Prices and wages

Jun 13th 2002
From The Economist print edition

% change at annual rate

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.9	Q1	+ 6.0	+ 2.6	+ 2.5	+ 0.5	Q1	+ 5.2	+ 4.3	Q1	+ 5.6
Austria	+ 1.8	Apr	+ 3.0	+ 1.7	+ 1.7	– 0.8	May	+ 3.1	+ 2.4	Apr	+ 2.6
Belgium	+ 1.3	May	+ 3.1	+ 2.0	+ 1.7	+ 1.4	Apr	+ 3.3	+ 3.1	Q1	+ 1.9
Britain	+ 1.5	Apr	+ 1.8	+ 2.1	+ 2.5	+ 0.1	May	+ 0.7	+ 2.9	Mar	+ 5.0
Canada	+ 1.7	Apr	+ 3.6	+ 1.5	+ 2.1	– 1.5	Apr	+ 2.7	+ 3.3	Mar	+ 1.2
Denmark	+ 2.1	May	+ 2.7	+ 2.4	+ 2.1	+ 0.3	Apr	+ 3.6	+ 4.1	Q4	+ 3.8
France	+ 1.4	May	+ 2.3	+ 1.8	+ 1.5	– 0.7	Apr	+ 3.0	+ 3.9	Q1	+ 4.3
Germany	+ 1.2	May	+ 3.5	+ 1.6	+ 1.4	– 0.5	Apr	+ 4.1	+ 2.4	Mar	+ 1.6
Italy	+ 2.3	May	+ 3.0	+ 2.2	+ 2.1	– 1.2	Apr	+ 4.3	+ 2.6	Apr	+ 2.6
Japan	– 1.1	Apr	– 0.7	– 0.9	– 0.6	– 0.9	May	+ 0.9	+ 0.1	Apr	+ 0.1
Netherlands	+ 3.3	May	+ 4.9	+ 3.6	+ 2.5	– 0.7	Apr	+ 6.2	+ 3.1	Apr	+ 4.6
Spain	+ 3.6	May	+ 4.2	+ 3.1	+ 2.6	+ 0.8	Apr	+ 2.8	+ 3.7	Q4	na
Sweden	+ 2.5	Apr	+ 2.8	+ 2.4	+ 2.1	– 0.7	Apr	+ 3.3	+ 4.0	Mar	+ 3.4
Switzerland	+ 0.6	May	+ 1.8	+ 0.8	+ 1.2	– 1.5	Apr	+ 0.9	+ 2.5	2001	+ 1.3
United States	+ 1.6	Apr	+ 3.3	+ 1.6	+ 2.3	– 2.0	Apr	+ 3.7	+ 3.2	May	+ 4.2
Euro area	+ 2.0	May	+ 3.4	+ 2.1	+ 1.8	– 0.7	Apr	+ 4.2	+ 3.0	Q4	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.8	Apr	+ 2.9	na	na	– 1.0	Apr	+ 2.9	+ 4.6	Q4	+ 5.0
Greece	+ 3.4	May	+ 3.6	na	na	+ 3.7	Mar	+ 4.3	na		na
Iceland	+ 4.8	Jun	+ 6.8	na	na	+ 7.4	May	+ 5.7	+ 8.0	Apr	+ 9.2
Ireland	+ 4.8	Apr	+ 5.6	na	na	+ 1.0	Apr	+ 3.1	+ 8.1	Q4	+ 6.4
Luxembourg	+ 1.9	May	+ 3.3	na	na	– 3.0	Mar	+ 3.9	+ 0.1	Mar	+ 6.7
New Zealand	+ 2.6	Q1	+ 3.1	na	na	+ 2.8	Q1	+ 8.0	+ 2.1	Q1	+ 1.8
Norway	+ 0.4	May	+ 4.3	na	na	–11.3	May	+ 4.6	+ 4.6	Q1	+ 4.4
Portugal	+ 3.6	Apr	+ 4.5	na	na	– 1.5	Apr	+ 3.2	na		na

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Switzerland

Jun 13th 2002
From The Economist print edition

It is still one of the richest countries in the world, but the gap between Switzerland and most other OECD countries has narrowed in the past 20 years. Part of the reason for Switzerland's relatively slow growth rate, says the OECD in a recent report, is its low productivity growth and its product-market weaknesses. Reform of the health, agriculture and energy sectors would bring great gains. The rescue of the country's national airline last year was “difficult to avoid”, but the amount of public aid provided, says the report, “seems larger than desired”, and the viability of the new airline looks uncertain. The affair also revealed weaknesses in corporate governance. For all that, Switzerland's macroeconomic policies look sound: the OECD praises a new budget-policy system, intended to limit the level of federal spending to cyclically adjusted revenues.

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Money and interest rates

Jun 13th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jun 12th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 1.3	+15.7	Apr	5.02	5.01	5.61	6.10	5.86	7.17‡
Britain	+ 8.0	+ 5.7	Apr	4.13	5.22	4.70	5.19	5.20	6.16
Canada	+12.8	+ 5.7	Apr	2.68	4.27	4.14	5.51	5.68	7.00
Denmark	+ 7.3	+ 8.2	Apr	3.75	5.05	4.37	5.27	5.32	6.95
Japan	+31.9	+ 3.5	May	0.02	0.01	0.02	1.34	1.16	1.44
Sweden	+ 6.4	+ 7.4	Jan	4.25	4.03	4.95	5.47	5.38	5.55
Switzerland	+ 5.5	+ 3.4	Apr	1.27	3.11	2.01	3.27	3.39	3.92
United States	+ 5.8	+ 8.3	Apr	1.78	3.79	3.03	4.95	5.26	6.85
Euro area†	+ 6.9	+ 7.5	Apr	3.47	4.47	4.11	5.03	5.02	5.80

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. ‡ New series. Benchmarks: US 30-year 5.54%, Japan No.239 1.38%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 13th 2002
From The Economist print edition

1995=100

	Jun 4th	Jun 11th*	% change on one month	% change on one year
Dollar index				
All items	69.9	69.7	+ 1.2	- 0.1
Food	70.4	69.5	+ 1.2	+ 2.5
Industrials				
All	69.2	69.9	+ 1.2	- 3.3
Nfa†	69.4	69.9	+ 0.0	- 2.6
Metals	69.0	70.0	+ 2.2	- 4.0
Sterling index				
All items	75.4	75.0	- 0.0	- 6.0
Euro index				
All items	97.4	97.2	- 3.2	-10.0
Yen index				
All items	92.2	93.1	- 1.3	+ 2.9
Gold				
$ per oz	325.30	317.35	+ 3.1	+17.7
West Texas Intermediate				
$ per barrel	24.88	24.30	-16.4	-17.7

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jun 13th 2002
From The Economist print edition

Market indices

	Jun 12th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,277.2	3,440.0	3,252.2	- 0.8	- 4.7	- 2.5	+ 8.6
Austria (ATX)	1,265.9	1,357.2	1,114.4	- 1.6	-27.1	+11.0	+18.0
Belgium (Bel 20)	2,593.0	2,899.8	2,593.0	- 2.0	-29.6	- 6.8	- 0.9
Britain (FTSE 100)	4,851.7	5,323.8	4,851.7	- 2.8	-30.0	- 7.0	- 6.0
Canada (Toronto Composite)	7,359.6	7,958.1	7,398.8	- 2.5	-35.4	- 4.3	- 0.6
Denmark (KBX)	213.6	233.4	212.8	- 0.4	-29.2	- 5.0	+ 1.0
France (SBF 250)	2,680.2	3,081.9	2,680.2	- 1.8	-39.0	-10.1	- 4.4
(CAC 40)	4,004.8	4,688.0	4,004.8	- 1.8	-42.1	-13.4	- 8.0
Germany (Xetra DAX)	4,510.2	5,462.6	4,510.2	- 2.5	-44.1	-12.6	- 7.1
Italy (BCI)	1,327.2	1,513.0	1,299.1	- 0.6	-39.2	- 7.4	- 1.6
Japan (Nikkei 225)	11,327.1	11,979.9	9,420.9	- 2.9	-70.9	+ 7.4	+12.1
(Topix)	1,093.7	1,139.4	922.5	- 2.0	-62.1	+ 6.0	+10.6
Netherlands (AEX)	447.0	531.2	447.0	- 3.5	-36.3	-11.8	- 6.3
Spain (Madrid SE)	768.5	848.1	768.5	- 2.1	-33.0	- 6.8	- 0.9
Sweden (Affarsvarlden Gen)	181.2	236.8	181.2	- 4.2	-54.7	-21.7	-15.1
Switzerland (Swiss Market)	6,142.0	6,694.1	6,105.2	- 4.0	-27.0	- 4.3	+ 1.8
United States (DJIA)	9,617.7	10,635.3	9,517.3	- 1.8	-18.0	- 4.0	- 4.0
(S&P 500)	1,020.3	1,172.5	1,013.6	- 2.8	-33.2	-11.1	-11.1
(Nasdaq Comp)	1,519.1	2,059.4	1,497.2	- 4.8	-69.9	-22.1	-22.1
Europe (FTSE Eurotop 300)*	1,105.6	1,279.7	1,105.6	- 2.8	-35.2	-12.3	- 6.8
Euro area (FTSE Ebloc 100)*	946.3	1,125.1	946.3	- 2.6	-39.0	-14.9	- 9.6
World (MSCI)†	924.7	1,024.4	924.7	- 2.6	-36.2	na	- 7.9
World bond market (Salomon)‡	463.7	463.7	430.3	+ 0.5	+ 0.8	na	+ 5.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 13th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Jun 12th	year ago	Currency units per $ Jun 12th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	+ 1.0	Apr	− 9.5	Q1	− 3.5	− 3.6	78.0	74.7	1.75	1.89	2.58	1.66	1.40	0.1
Austria	− 3.0	Feb	− 2.8	Mar	− 2.2	− 2.0	100.8	99.8	1.06	1.17	1.55	–	0.84	-0.3
Belgium	+ 11.5	Mar	+ 13.0	Dec	+ 5.1	+ 5.3	100.0	98.2	1.06	1.17	1.55	–	0.84	nil
Britain	− 47.1	Apr	− 25.1	Q4	− 2.2	− 2.1	103.6	105.8	0.68	0.72	–	0.64	0.54	-0.8
Canada	+ 36.2	Mar	+ 14.7	Q1	+ 2.2	+ 2.5	77.9	79.6	1.54	1.52	2.26	1.45	1.22	1.0
Denmark	+ 7.0	Mar	+ 3.4	Mar	+ 1.9	+ 1.9	102.8	101.2	7.86	8.76	11.6	7.44	6.26	2.2
France	+ 5.4	Mar	+ 23.6	Mar	+ 1.7	+ 1.7	102.7	100.7	1.06	1.17	1.55	–	0.84	-2.0
Germany	+ 94.5	Apr	+ 14.9	Apr	+ 0.7	+ 0.8	99.9	97.5	1.06	1.17	1.55	–	0.84	-2.8
Italy	+ 8.9	Mar	+ 1.5	Feb	+ 0.1	nil	73.3	71.9	1.06	1.17	1.55	–	0.84	-1.4
Japan	+ 72.6	Mar	+ 97.2	Apr	+ 2.6	+ 2.6	130.9	141.1	126	122	185	119	–	-8.0
Netherlands	+ 22.8	Apr	+ 13.6	Q1	+ 3.7	+ 4.0	99.0	97.0	1.06	1.17	1.55	–	0.84	0.1
Spain	− 37.1	Mar	− 15.8	Feb	− 2.1	− 1.8	74.9	73.6	1.06	1.17	1.55	–	0.84	-0.3
Sweden	+ 14.0	Apr	+ 7.4	Mar	+ 3.1	+ 3.2	77.1	74.9	9.7	10.8	14.2	9.16	7.71	2.1
Switzerland	+ 2.1	Apr	+ 24.6	Q4	+ 9.7	+ 9.9	113.1	106.9	1.56	1.79	2.30	1.48	1.24	na
United States	−421.4	Mar	−417.4	Q4	− 4.2	− 4.5	116.7	120.4	–	–	1.47	0.95	0.80	-1.0
Euro area	+ 58.9	Mar	− 2.0	Mar	+ 0.3	+ 0.4	81.3	76.7	1.06	1.17	1.55	–	0.84	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.1	Apr	+ 7.5	Mar	na	na	78.9	77.4	1.06	1.17	1.56	–	0.84	3.2
Greece	− 19.1	Dec	− 7.2	Dec	na	na	58.0	57.0	1.06	1.17	1.56	–	0.84	0.4
Iceland	+ 0.1	Apr	− 0.4	Q4	na	na	na	na	89.6	105	132	84.8	71.3	-0.5
Ireland	+ 32.5	Mar	− 1.1	Q4	na	na	89.2	86.1	1.06	1.17	1.56	–	0.84	0.1
Luxembourg	− 2.9	Feb	+ 0.9	Q4	na	na	100.0	98.2	1.06	1.17	1.56	–	0.84	2.2
New Zealand	+ 0.2	Apr	− 1.6	Q4	na	na	91.5	81.0	2.03	2.37	2.99	1.92	1.62	0.1
Norway	+ 24.7	Apr	+ 22.2	Feb	na	na	104.4	95.2	7.84	9.36	11.5	7.42	6.24	14.0
Portugal	− 13.1	Mar	− 9.8	Mar	na	na	90.0	88.8	1.06	1.17	1.56	–	0.84	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast.

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Exchange rates against the dollar

Jun 13th 2002
From The Economist print edition

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Overview

Jun 13th 2002
From The Economist print edition

Industrial production in **China** rose by 12.9% in the year to May, well above the 9% target set by the government. In **Malaysia**, industrial output recovered sharply, rising by 3.8% in the year to April. Industrial production in **India** grew by 2.9% over the same period.

China's stockmarket rose by 4.3%; **South Korea's** went up by 1.7%. Share prices fell by 6.5% in **Turkey** and by 4.0% in **Israel**.

Colombia's economic growth shrank to 0.5% in the year to the first quarter. In **Chile**, growth slipped to 1.5% in the same period.

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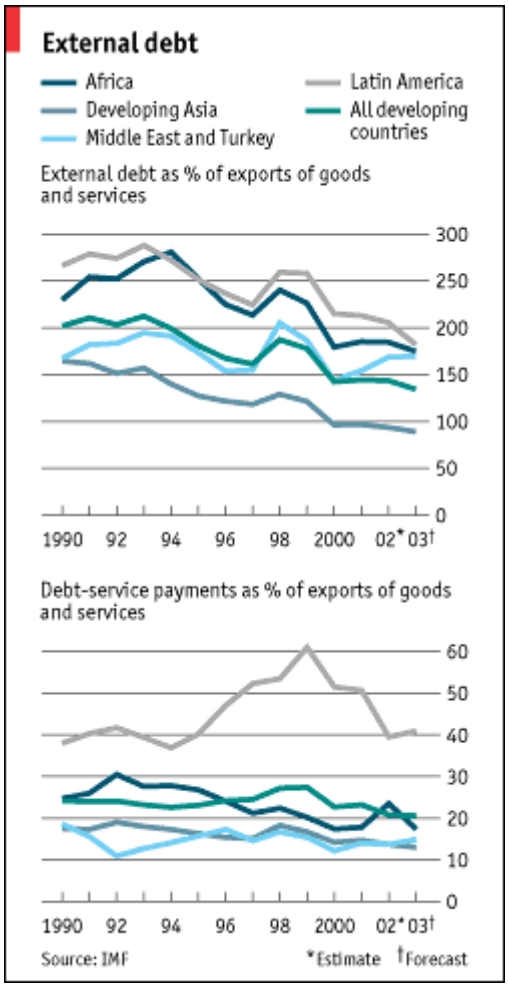
External debt

Jun 13th 2002
From The Economist print edition

Latin American countries' debts to foreigners loom especially large in comparison with their exports. That is largely because many Latin American economies have small exports relative to their size. In emerging Asia, by contrast, exports are a far larger portion of GDP. In 2001, according to the IMF, Latin America's debt-to-export ratio was 213%, compared with Africa's ratio of 185%. Debt-service payments are also more onerous in Latin America than elsewhere: in 2001, Latin America's ratio of debt service to exports was 51%, more than twice as high as that of other regions.



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Economy

Jun 13th 2002
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.6	Q1	+12.9	May	– 1.1	May	+25.8	May	+21.2	2001§	230.9	Mar
Hong Kong	– 0.9	Q1	– 9.3	Q4	– 3.0	Apr	– 8.8	Apr	+12.0	Q4	111.3	May
India	+ 6.3	Q4	+ 2.9	Apr	+ 4.7	Apr	– 5.8	Apr	– 0.1	Q4	52.9	May
Indonesia	+ 2.5	Q1	– 2.2	Q3	+12.9	May	+26.6	Apr	+ 8.4	Q3	27.3	Apr
Malaysia	+ 1.1	Q1	+ 3.8	Apr	+ 1.6	May	+13.5	Apr	+ 6.9	Q4	32.8	Apr
Philippines	+ 3.8	Q1	– 1.2	Mar	+ 3.6	May	+ 2.3	Mar	+ 5.0	Feb	14.4	May
Singapore	– 1.7	Q1	+ 8.1	Apr	– 1.1	Apr	+ 5.7	Apr	+18.4	Q1	78.2	May
South Korea	+ 5.7	Q1	+ 7.3	Apr	+ 3.0	May	+ 9.0	May	+ 7.0	Apr	107.6	Apr
Taiwan	+ 0.9	Q1	+ 7.5	Apr	– 0.3	May	+18.7	May	+22.0	Q1	139.8	May
Thailand	+ 2.1	Q4	+ 9.2	Apr	+ 0.1	May	+ 4.1	Apr	+ 6.0	Apr	33.7	Apr
Argentina	–10.7	Q4	–13.3	Apr	+23.0	May	+10.8	Apr	– 4.4	Q4	12.2	Apr
Brazil	– 0.7	Q1	+ 6.0	Apr	+ 8.0	Apr†	+ 4.9	May	–19.3	Apr	33.0	Apr
Chile	+ 1.5	Q1	+ 6.6	Apr	+ 2.1	May	+ 1.7	Apr	– 1.0	Q1	15.3	Apr
Colombia	+ 0.5	Q1	–11.0	Mar	+ 5.8	May	+ 0.6	Mar	– 1.7	Q4	10.4	Apr
Mexico	– 2.0	Q1	+ 8.0	Apr	+ 4.7	May	– 9.2	Apr	–16.8	Q1	45.1	Apr
Peru	+ 7.5	Apr	– 2.4	Mar	+ 0.2	May	+ 0.1	Mar	– 1.0	Q1	8.7	Apr
Venezuela	– 4.2	Q1	+ 9.7	Jan	+18.3	May	+ 8.0	Q1	+ 1.8	Q1	6.2	Mar
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.5	Mar	– 8.6	Jan	– 0.1	Q4	12.5	Feb
Israel	– 4.2	Q1	–10.0	Mar	+ 5.0	Apr	– 5.8	May	– 1.7	Q4	24.3	May
South Africa	+ 2.1	Q1	+12.5	Apr	+ 8.0	Apr	+ 3.7	Apr	– 0.2	Q4	6.0	Apr
Turkey	–10.4	Q4	+14.1	Apr	+46.2	May	– 8.0	Mar	+ 3.7	Mar	23.6	Apr
Czech Republic	+ 3.2	Q4	+ 8.2	Apr	+ 2.5	May	– 2.4	Apr	– 2.4	Q1	20.2	May
Hungary	+ 2.9	Q1	– 0.3	Apr	+ 5.6	May	– 2.3	Apr	– 1.6	Apr	9.8	May
Poland	+ 0.3	Q4	+ 0.2	Apr	+ 3.0	Apr	–11.1	Apr	– 0.8	Apr	26.2	Apr
Russia	+ 3.7	Q1	+ 4.3	Apr	+16.2	May	+44.8	Apr	+31.2	Q1	35.0	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+16.3	Jan	+ 2.9	May	– 1.1	May	+ 0.3	2001†	4.0	Apr
Saudi Arabia	+ 1.2	2001	na		nil	Feb	+44.1	2001	+14.5	2001	17.7	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June. §Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jun 13th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 12th		Dec 31st 2001	
	Jun 12th	year ago	Jun 12th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.2	na	1,591.5	+4.3	– 7.1	– 7.1
Hong Kong	7.80	7.80	11.5	1.82	11,148.0	– 2.2	– 2.2	– 2.2
India	49.0	47.0	72.0	6.42	3,344.4	+2.7	+ 2.5	+ 1.0
Indonesia	8,735	11,225	12,849	16.15	524.0	+0.7	+ 33.7	+ 59.1
Malaysia	3.80	3.80	5.59	3.25	750.6	+0.5	+ 7.8	+ 7.8
Philippines	50.4	51.4	74.2	6.50	1,274.4	– 2.8	+ 9.1	+ 11.6
Singapore	1.79	1.82	2.63	0.81	1,646.0	– 0.5	+ 1.4	+ 4.7
South Korea	1,224	1,292	1,800	4.83	823.1	+1.7	+ 18.6	+ 27.4
Taiwan	34.0	34.4	50.0	2.45	5,400.0	– 3.6	– 2.7	+ 0.2
Thailand	42.3	45.4	62.3	2.13	423.6	+3.1	+ 39.4	+ 45.7
Argentina	3.41	1.00	5.02	48.60	275.7	– 5.7	– 6.7	– 72.6
Brazil	2.74	2.41	4.03	18.19	12,133.0	– 3.6	– 10.6	– 24.6
Chile	667	614	982	3.84	5,045.7	– 1.1	– 6.5	– 7.4
Colombia	2,347	2,307	3,452	8.82	1,235.4	+4.8	+ 15.4	+ 12.0
Mexico	9.70	9.12	14.3	7.23	6,801.7	– 2.5	+ 6.7	+ 0.9
Peru	3.47	3.52	5.10	2.61	1,191.9	– 3.3	+ 1.4	+ 0.7
Venezuela	1,151	716	1,692	38.19	7,435.5	– 0.1	+ 13.2	– 25.5
Egypt	4.64	3.88	6.83	7.19	5,334.8	+1.1	+ 1.2	– 0.3
Israel	4.97	4.15	7.32	4.78	362.1	– 4.0	– 18.9	– 28.1
South Africa	10.2	8.09	14.9	11.85	11,132.0	– 1.3	+ 6.6	+ 25.8
Turkey	1,553,500	1,243,000	2,285,199	43.00	9,704.1	– 6.5	– 29.6	– 34.1
Czech Republic	32.1	39.8	47.2	3.81	459.2	– 0.2	+ 16.4	+ 28.9
Hungary	255	290	375	9.20	7,982.4	– 2.0	+ 11.9	+ 20.5
Poland	4.01	3.96	5.90	9.41	15,559.4	– 0.9	+ 11.8	+ 10.1
Russia	31.4	29.1	46.2	23.00	396.2‡	+2.3	+ 57.0	+ 52.3
EMF (MSCI)*	1.00	1.00	1.47	na	339.5	– 2.0	na	+ 7.0
EMBI+†	1.00	1.00	1.47	na	206.4	– 2.2	na	+ 3.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. June 11th.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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